HHL LEIPZIG GRADUATE SCHOOL OF MANAGEMENT

Dissertation

Conceptual and Historical Underpinnings of Accounting

Dominic Detzen

Email: dominic.detzen@hhl.de

Abstract:
This cumulative dissertation covers the conceptual foundations and historical evolution of various aspects in accounting. The first article discusses the conceptual framework of the U.S. standard setter FASB and shows that the evolution of the U.S. GAAP conceptual framework in the 1970s and 1980s was considerably influenced by economic factors. The second manuscript employs a conditional-normative approach to analyze the 2010 joint conceptual framework of the international and the U.S. standard setter, in particular the qualitative characteristics of useful financial information. The paper shows that the qualitative characteristics are not a sufficient basis for developing accounting standards. The third article focuses on the regulatory history of asset valuation in Germany and explains regulatory changes by socio-economic and political events. The fourth and final article contains a historical-critical analysis of the concept of accountability, which forms the basis of accounting. The article analyzes accountability at a German university during the Nazi regime and illustrates the limits of the concept.

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Dominic Detzen, M.A. HSG

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First Assessor:

Prof. Dr. Henning Zülch

HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing

Second Assessor:

Prof. Dr. Torsten Wulf

Philipps-University Marburg
Chair of Strategic and International Management

OVERVIEW PAGE

I. Conceptual and Historical Underpinnings of Accounting – An Overview of the Cumulative Dissertation ... 7

1 Introduction to the Research Context ... 9
2 Overview and Findings of the Manuscripts ... 13

II. Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984 ... 21

1 Introduction ... 24
2 The Early Debates: Considering Change ... 28
3 Challenging the Existing Accounting Model ... 38
4 Implementing Change in the Conceptual Framework? ... 52
5 Conclusions ... 65

III. The Conceptual Framework's (In-)Adequacy for Standard Setting ... 77

1 Introduction ... 80
2 Analytical Framework ... 84
3 Evaluation Method ... 93
4 Analysis ... 110
5 Conclusions ... 125

IV. The Regulation of Asset Valuation in Germany ... 133

1 Introduction ... 136
2 The Corporate Environment in Germany ... 140
3 Up to 1870: Germany Diverts from Historical Cost Accounting ... 142
4 1870 – 1884: The *Gründerkrise* Reveals Regulatory Deficiencies ... 152
5 1884 – 1937: Principles-Based Accounting Emerges and Reacts to Crises ... 160
6 1937 – 1986: Historical Cost Accounting Spreads ... 174
7 Conclusion ... 177

V. On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism ... 187

1 Introduction ... 190
2 Germany's Business Schools and HHL from 1898 to 1933 ... 195
3 *Gleichschaltung* of Charters and Regulations: 1933 to 1935 ... 203
4 Dispersion of Accountability: 1935 to 1945 ... 218
5 Conclusions ... 234

Contents

I. Conceptual and Historical Underpinnings of Accounting – An Overview of the Cumulative Dissertation 7

1 Introduction to the Research Context 9
2 Overview and Findings of the Manuscripts 13

II. Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984 21

1 Introduction 24
2 The Early Debates: Considering Change 28

2.1 The Pre-FASB Accounting Model 28
2.2 Foreign Currency Translation: The FASB's First Attempt 30
2.3 The Beginnings of the Conceptual Framework Project 33

3 Challenging the Existing Accounting Model 38

3.1 Coping with Inflation: Loosening the Grip on Historical Costs 38
3.2 Giving in to Pressure: Foreign Currency Translation Revisited 43
3.3 The Trouble Ends: A Declining Inflation Rate 49

4 Implementing Change in the Conceptual Framework? 52

4.1 Towards a New Income Concept 52
4.2 Stopping Short of Change 58

5 Conclusions 65

III. The Conceptual Framework's (In-)Adequacy for Standard Setting 77

1 Introduction 80
2 Analytical Framework 84

2.1 Outline of the Analysis 84
2.2 Normative Theory and Accounting Concepts 88

3 Evaluation Method 93

3.1 First Evaluation Level: Relevance 96
3.2 First Evaluation Level: Faithful Representation 101
3.3 Second Evaluation Level: Comparability 105
3.4 Second Evaluation Level: Verifiability 106
3.5 Second Evaluation Level: Timeliness 107
3.6 Second Evaluation Level: Understandability 108
3.7 Assessment of Second Evaluation Level 108

4 Analysis 110

4.1 First Level Analysis: Relevance 110

4.1.1 Full Capitalization 110
4.1.2 Full Expensing 112
4.1.3 Contra-Equity Accounting 113
4.1.4 Partial Capitalization 114

4.2 First Level Analysis: Faithful Representation 115

4.2.1 Full Capitalization 115
4.2.2 Full Expensing 116
4.2.3 Contra-Equity Accounting 117
4.2.4 Partial Capitalization 118
4.2.5 Summary of First Level Analysis 119

4.3 Second Level Analysis 122

5 Conclusions 125

IV. The Regulation of Asset Valuation in Germany 133

1 Introduction 136
2 The Corporate Environment in Germany 140
3 Up to 1870: Germany Diverts from Historical Cost Accounting 142

3.1 The Origins of Valuation: Inventory Accounting 142
3.2 Heterogeneous Regulation in Independent German States 144
3.3 Harmonizing Accounting Regulation: The ADHGB 146

4 1870 – 1884: The *Gründerkrise* Reveals Regulatory Deficiencies 152

4.1 *1. Aktienrechtsnovelle* (1870): A laissez-faire approach 152
4.2 The *Gründerkrise* and the Overvaluation of Assets 154
4.3 Lessons Learned from the Crisis? – *2. Aktienrechtsnovelle* (1884) 156

5 1884 – 1937: Principles-Based Accounting Emerges and Reacts to Crises 160

5.1 The Rise of Principles-Based Accounting 160
5.2 Principles-Based Valuation and Accounting Theory 164
5.3 Valuation in Times of Trouble: The Years of Hyperinflation 166
5.4 The Golden 20s, the Great Depression and Afterwards: Blaming *Aktiengesellschaften* (Again) 169

6 1937 – 1986: Historical Cost Accounting Spreads 174
7 Conclusion 177

V. On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism ... 187

1 Introduction ... 190
2 Germany's Business Schools and HHL from 1898 to 1933 ... 195

2.1 The Evolution of German Business Schools: 1898 to 1930 ... 195
2.2 Focusing on Professional Accountability: 1930 to 1933 ... 197

3 *Gleichschaltung* of Charters and Regulations: 1933 to 1935 ... 203

3.1 First Steps towards Coordination: 1933 ... 203
3.2 Dissemination of the Ideology: Aryan Faculty, Party Membership and Denunciations ... 207
3.3 Implementing New Forms of Accountability: 1934 to 1935 ... 211

4 Dispersion of Accountability: 1935 to 1945 ... 218

4.1 Major Changes of HHL's Faculty: 1935 to 1937 ... 218
4.2 A Zealot Hands Over to a Liberal: 1937 to 1939 ... 223
4.3 Hasenack's Opposition in Times of War: 1939 to 1944 ... 228
4.4 Outlook – The Regime's Dissolution: 1945 ... 232

5 Conclusions ... 234

I.

Conceptual and Historical Underpinnings of Accounting – An Overview of the Cumulative Dissertation

Dominic Detzen
Research Associate
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: dominic.detzen@hhl.de
tel. +49 (0) 3 41 – 9851 670

I. Conceptual and Historical Underpinnings of Accounting – An Overview of the Cumulative Dissertation

1 Introduction to the Research Context **9**
2 Overview and Findings of the Manuscripts **13**

1 Introduction to the Research Context

Accounting can be traced back to ancient civilizations that used it for a variety of purposes ranging from recording transactions to contracting and taxation (see, e.g., Carmona and Ezzamel, 2009). Most of these functions have persisted throughout history, whereas others have been added. Accounting has emerged as the backbone of our society in that it represents the central pillar of a functioning corporate and financial world. Over the last century, we have witnessed a professionalization of accounting practice and an increase in the regulation of accounting, in particular financial reporting. Corresponding to that evolution, accounting research, starting in the late 1960s, has changed from a normative to a more positive, economic-driven, approach, representing a development that has been likened to a Kuhnian paradigm shift (Cushing, 1989). Nonetheless, understanding the conceptual and historical foundations of accounting remains vital, as can be seen by the relative flourishing of accounting history research in the 1990s, which represents the "golden decade" of the research stream (Fleischman and Radcliffe, 2005). Since then, normative and historical research has been established as an essential research approach in accounting, also evidenced by the rise of historiographies, i.e. studies of "how and why accounting has been written about as an object of historical study" (Napier, 2009, p. 30).

The four manuscripts of this cumulative dissertation are to provide "insights into accounting's present and future through its past" (Carnegie and Napier, 1996). Summarized under the title "Conceptual and Historical Underpinnings of Accounting", the manuscripts can be classified into two major areas (see Figure 1). Manuscript A (chapter II.) and Manuscript B (chapter III.) focus on the conceptual foundations of financial reporting, in particular according to United States Generally Accepted Accounting Principles (US GAAP) and International Financial Reporting Standards (IFRS). Manuscript C (chapter IV.) and Manuscript D (chapter V.) analyze historical underpinnings of accounting in the German context by focusing on regulatory aspects and the accountability concept, respectively.

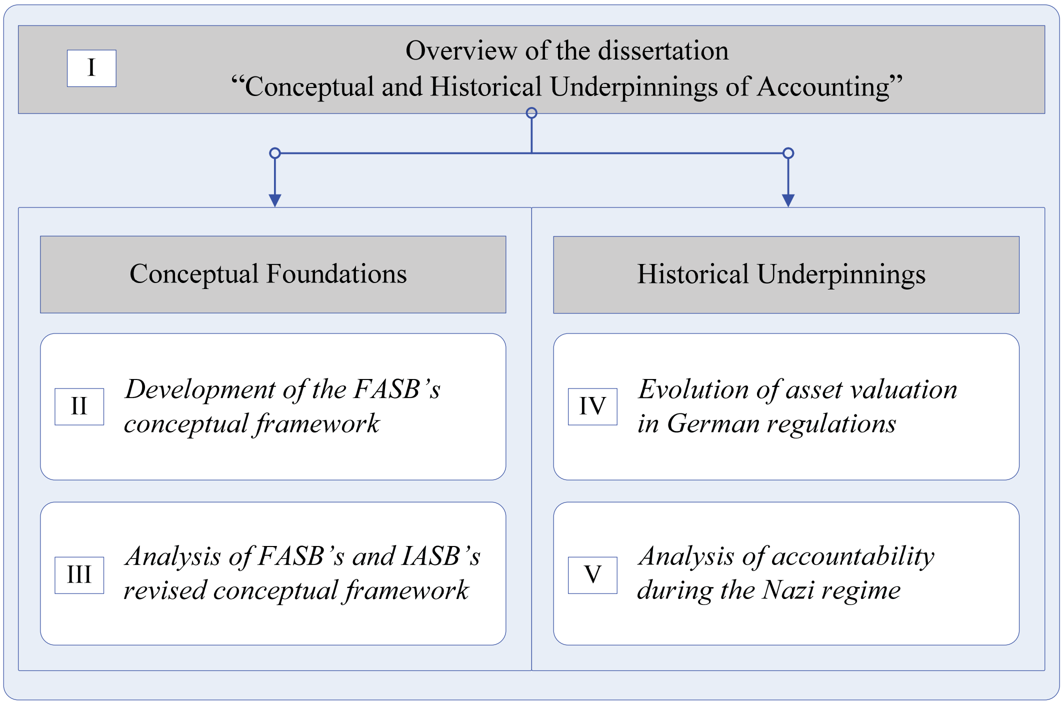

Figure 1: Organization of Dissertation

The first manuscript, entitled "**Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984**", investigates the conceptual framework project of the US standard setting body, the Financial Accounting Standards Board (FASB). While the framework has been subject to a large number of studies (e.g. Zeff, 1999), Manuscript A contributes to the accounting literature by examining in detail how the adverse economic environment in the 1970s and 1980s affected the course and the eventual outcome of the conceptual framework project. By doing so, the study sheds light on how the concept of "other comprehensive income" was introduced into US GAAP and the FASB's conceptual framework. These aspects have not yet been covered by the accounting literature and are particularly relevant given that standard setters are in deliberations regarding a revised conceptual framework and a conceptual basis for other comprehensive income.

Manuscript B, "**The Conceptual Framework's (In-)Adequacy for Standard Setting**", follows up on the previous manuscript by examining the joint conceptual framework of the FASB and the International Accounting Standards Board (IASB). The Boards are in the process of revising their individual conceptual frameworks and in 2010 issued parts of their joint work, which covered the objective of general purpose financial reporting and the qualitative characteristics of useful financial information. The manuscript contains a normative analysis of the qualitative characteristics by analyzing whether and to what extent they are suited to recommend an accounting solution to a controversial standard setting issue, such as the accounting for research and development expenditures. The article contributes to the literature by providing a timely analysis of the new conceptual framework and by informing the current standard setting debate on both the conceptual framework and research and development expenditures, which, in due time, will return to the standard setters' agendas.

The second stream of the dissertation, which covers historical underpinnings of accounting, begins with Manuscript C, entitled "**The Regulation of Asset Valuation in Germany**". Given there is only little literature in English on German accounting history (Evans, 2005, p. 229), a longitudinal study seems particularly suited to provide an overview of regulatory aspects of asset valuation in German.

The article analyzes how regulation has evolved over the years by reacting to the socio-economic and political environment and thus provides the historical background to the debate on fair value accounting in the most recent financial crisis. Supplementing the literature by the German case, the manuscript adds to recent articles on the history of fair valuation, e.g. in Britain (Georgiou and Jack, 2011), France (Richard, 2004) and the United States (Nouri and Pannone, 2010).

Manuscript D, "**The Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism**", draws on the extreme conditions imposed on the German society during the Nazi regime to examine the concept of accountability at a university, i.e. an institution of higher morality (Rorty, Reuben, Marsden, 2000). The manuscript sheds light on how excessive demand for accountability poses an ethical and moral threat in that it violates the accountable self and corrupts its personal conscience. The study connects to the literature on accountability and contributes to this area by furthering our understanding of the limitations of accountability, which have been theorized only recently (Messner, 2009) and on which little evidence exists so far in the accounting literature.

2 Overview and Findings of the Manuscripts

The article "**Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984**" is a historical study that explains how two economic forces of the 1970s and 1980s, namely volatile exchange rates and high rates of inflation, affected the FASB's debates on a conceptual foundation for financial reporting and standard setting. The rising price environment of the time encouraged the standard setter to consider a move towards greater flexibility in measurement of financial statement elements. By contrast, the accounting for foreign currency translation had first been addressed in 1974 when the FASB issued an accounting standard that was highly controversial. The volatility of exchange rates produced a strong sentiment against the standard such that the FASB reconsidered it and embraced a distortion of the traditional income concept, which later became known as other comprehensive income. The distortion was expected to be healed in the course of the conceptual framework project. However, due to controversies, the FASB eventually abandoned further work on reporting income and included an insufficient ex-post rationalization of other comprehensive income in the concepts statement on recognition and measurement, making the new concept largely unprincipled. The study, which is solely authored by the doctoral candidate, has been discussed with several people that were involved in the above-mentioned standard setting project. Among them are then-FASB Chairman Donald Kirk, then-FASB Director of Research and Technical Activities Jim Leisenring and then-FASB Project Manager Tim Lucas. In addition, the study has been presented at one of HHL's research colloquia on January 18, 2013 and at the Bundeswehr University in Munich on February 5, 2013. The article is intended for submission to *Accounting Horizons* (ISSN 0888-7993).

The manuscript "**The Conceptual Framework's (In-)Adequacy for Standard Setting**" analyzes normatively whether the joint conceptual framework of FASB and IASB is suited for its major purpose, i.e. to help the Boards find a solution to a standard setting issue. Assuming absence of political and pragmatic compromises, the study employs accounting theories to derive accounting methods for the controversial issue of research and development expenditures. To complement the article's conditional-normative approach, the accounting alternatives are assessed against the standard setters' qualitative characteristics, which is an approach the Boards assert to use. Instead of coming up with an accounting method that is in line with accounting theory and the conceptual framework, the study shows that the conceptual framework can hardly be used as a normative-deductive basis for standard setting issues. As a result, an analysis that relies on the framework is inevitably based on assumptions and interpretations. The article thus points to major concerns regarding the conceptual framework's adequacy for standard setting, which pertain to inconsistent and incomplete definitions, and shows how the framework may be improved to provide a consistent basis for standard setting. The study is co-authored by Sebastian Hoffmann and the doctoral candidate. Different versions of it have been presented at a number of conferences and seminars, including the 35th Annual Congress of the European Accounting Association, held in May 2012, and the joint conference of the Accounting Section of the German Academic Association for Business Research (AS-VHB) and the International Association for Accounting Education and Research (IAAER), held in February 2013, as well as at the University of Dundee and the University of Strathclyde in March 2012 and the Free University of Amsterdam in March 2013. The article is intended for submission to *Schmalenbach Business Review* (ISSN 1439-2917) or *British Accounting Review* (ISSN 0890-8389).

The article "**The Regulation of Asset Valuation in Germany**" is a historical study that spans the time from the 15th century to the implementation of the European Economic Community's Fourth Directive in 1986. The longitudinal analysis places changes of asset valuation regulation in their socio-economic and political context, arguing that looser regulation was in vogue in times of economic booms, while valuation requirements often became more restrictive following crises. In the context of the 19th century industrialization, historical cost accounting was replaced by fair valuation, which subsequently saw much criticism during a severe economic crisis in the 1870s, the *Gründerkrise*. In the aftermath, stock companies, which were at the forefront of regulatory developments in Germany, were regulated more strictly in that these companies had to apply historical costs as an upper valuation boundary. Since the requirements left much room for interpretation and discretion, a lively debate arose after 1900, which centered on the objective and contents of principles-based accounting. Following the years of hyperinflation in the 1920s and the Great Depression, the government implemented historical costs as a lower boundary to asset valuation of stock companies in 1931. After World War II, these regulations were extended to all company forms, also as a result of the European harmonization efforts. The article, which is co-authored by Sebastian Hoffmann and the doctoral candidate, is accepted for publication in *Accounting History* (ISSN 1032-3732) and has been presented, inter alia, in a research seminar of the University of Stirling, held in March 2012, and at the joint conference of the Accounting Section of the German Academic Association for Business Research (AS-VHB) and the International Association for Accounting Education and Research (IAAER), held in February 2013.

The fourth manuscript, entitled "**On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism**", is a historical-critical analysis of the concept of accountability, according to which an accountable self is to take responsibility for fulfilling its duties and, if necessary, for any deviations from the targets imposed on it. The study argues that, during the Nazi regime from 1933 to 1945, an excessive demand for accountability was placed on the German society, which was required to politically align and act in the interests of the regime. By using the context of an institution of higher morality, which universities tend to represent, the study shows how the ubiquity of accountability altered organizations and individuals. In particular, it is shown that the regime changed the targets, with which the accountable self needed to comply, and threatened the accountable self with severe penalties. Evidence for these findings is presented regarding the school's charters and regulations, reporting, recruiting, publishing and educational routines. As a result, fear of penalization caused the accountable self to betray its personal conscience either by aligning with the ideology or, in contrast, by exploiting the regime for its personal benefit, e.g. by denunciations. Accountability, at the margin, is a decision and behavior influencing concept that ethically and morally violates the accountable self. The study extends the literature on the limitations of accountability by providing insights into the use and abuse of the concept in a dogmatic society. The article is co-authored by the doctoral candidate and Sebastian Hoffmann and is invited for presentation at the Cardiff Business School in May 2013. It is intended for submission to *Accounting, Organizations and Society* (ISSN 0361-3682) or *Accounting History Review* (ISSN 2155-2851).

Overall, the four manuscripts are to further our understanding of the conceptual foundations and the historical underpinnings of accounting as follows (see Figure 2):

(i) By providing new insights into the evolution of the FASB's conceptual framework, in general, and the concept of other comprehensive income, in particular (Manuscript A),

(ii) By analyzing normatively the revised conceptual framework's qualitative characteristics regarding their adequacy for solving a standard setting issue (Manuscript B),

(iii) By illustrating how the regulation of asset valuation in Germany responded to socio-economic and political sentiments and by providing afterthoughts to the debate on fair value accounting in the most recent financial crisis (Manuscript C), and

(iv) By discussing the limitations of the accountability concept, which, at the margin, ethically violates the accountable self, even at institutions of higher morality, which universities tend to represent (Manuscript D).

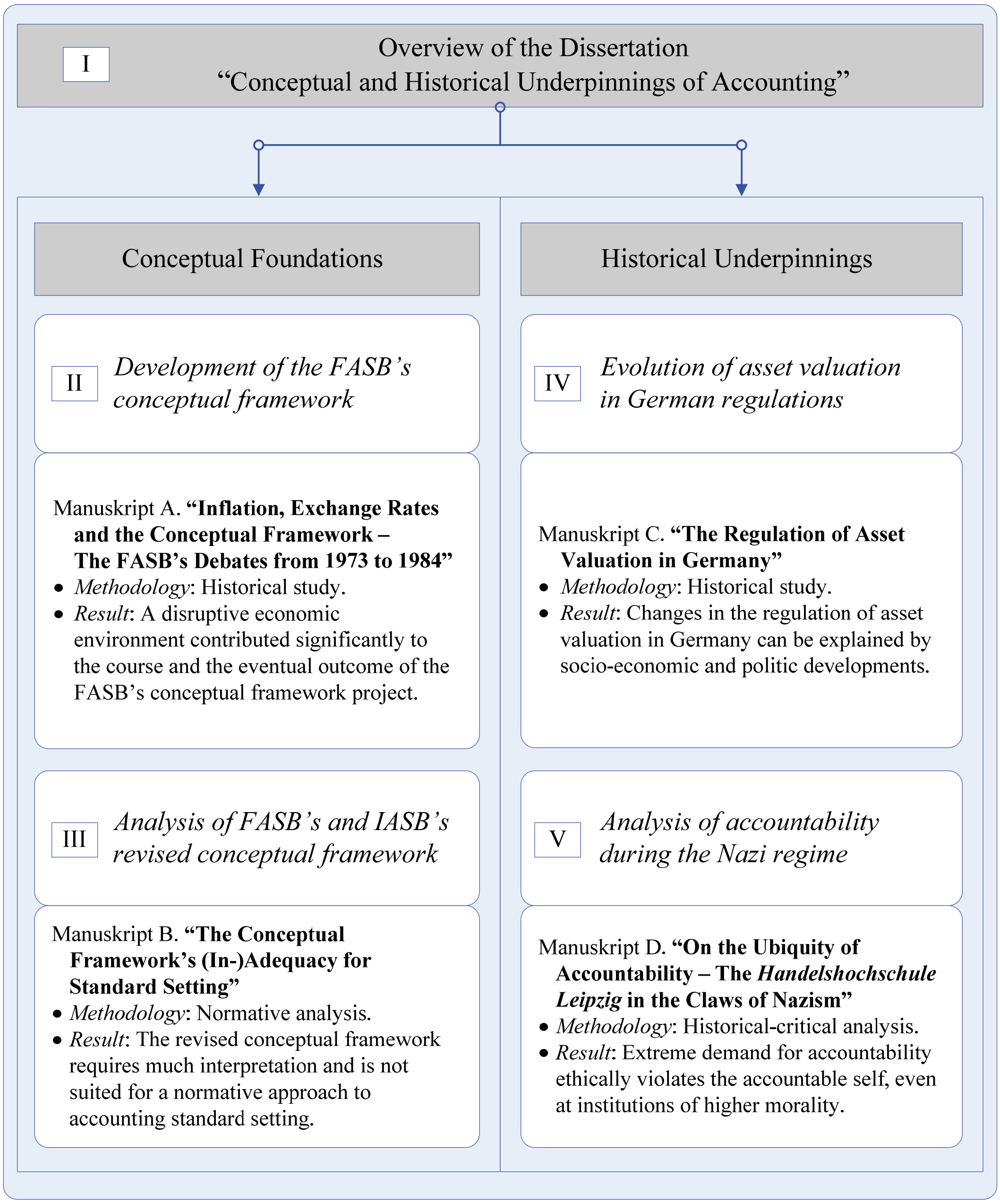

Figure 2: Results of the Dissertation

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II.

Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984

Manuscript A.

Dominic Detzen
Research Associate
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: dominic.detzen@hhl.de
tel. +49 (0) 3 41 – 9851 670

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II. Inflation, Exchange Rates and the Conceptual Framework – The FASB's Debates from 1973 to 1984

1 Introduction ... 24
2 The Early Debates: Considering Change ... 28

2.1 The Pre-FASB Accounting Model ... 28
2.2 Foreign Currency Translation: The FASB's First Attempt ... 30
2.3 The Beginnings of the Conceptual Framework Project ... 33

3 Challenging the Existing Accounting Model ... 38

3.1 Coping with Inflation: Loosening the Grip on Historical Costs ... 38
3.2 Giving in to Pressure: Foreign Currency Translation Revisited ... 43
3.3 The Trouble Ends: A Declining Inflation Rate ... 49

4 Implementing Change in the Conceptual Framework? ... 52

4.1 Towards a New Income Concept ... 52
4.2 Stopping Short of Change ... 58

5 Conclusions ... 65

INFLATION, EXCHANGE RATES AND THE CONCEPTUAL FRAMEWORK – THE FASB'S DEBATES FROM 1973 TO 1984

Abstract

In this historical study, I explain how two economic forces of the 1970s and 1980s, volatile exchange rates and inflation, affected the FASB's debates on its conceptual framework. While it has been acknowledged that rising prices contributed to a move towards greater flexibility in measurement, the impact of volatile exchange rates on the framework project has not been addressed so far. When, in 1976, a first foreign currency translation standard became effective, it sparked considerable controversy such that the FASB reconsidered the statement, embracing an exception to the all-inclusive income concept. This distortion, which later became known as other comprehensive income (OCI), was intended to be healed in the further course of the conceptual framework project. However, the Board was not able to agree on its recognition and measurement project, issuing a descriptive Concepts Statement No. 5. By abandoning further work on reporting income, the FASB included an insufficient ex-post justification of OCI in SFAC No. 5, making the concept largely unprincipled.

Keywords: current values, comprehensive income, inflation, foreign currency translation, conceptual framework, history

1 Introduction

Following the formation of the Securities and Exchange Commission (SEC) in the 1930s, the prevailing accounting model in the U.S. featured two characteristics: An all-inclusive income statement, in which all revenues, gains, expenses and losses are included regardless of whether or not they are recurring, as well as historical cost accounting, which purports valuation at historical cost in a company's financial statements. While challenges to this "traditional" accounting model have persisted throughout the years, it was not until the late 1970s that calls for a deviation from the prevalent model stood a chance.

In this article, I argue that the economic environment of the 1970s and 1980s left its mark on the members of the Financial Accounting Standards Board (FASB) and created a sense of urgency to change financial reporting. Volatile exchange rates following the demise of the Bretton Woods monetary system made the Board reconsider its first, highly controversial foreign currency translation statement and embrace an exception to the all-inclusive income statement.[1] This treatment became later known as "other comprehensive income" (OCI) accounting. The period of high inflation showed a need to account for the effects of price level changes in financial statements and produced supplementary disclosures of general price level and current cost data contributing to a perceived need for greater flexibility in measurement.

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[1] Statement of Financial Accounting Standard (SFAS) No. 12 "Accounting for Certain Marketable Securities", issued in December 1975, was the first disruption of the all-inclusive income concept by excluding from income changes in the valuation allowance, i.e. the difference between aggregate cost and market value of non-current securities (see, e.g., Grinnell and Norgaard, 1980). The Statement provided remedy to an industry-specific, high-priority emerging problem and did not include conceptual considerations. Walter Schuetze, a fervent fair value advocate, called SFAS No. 12 the FASB's "first crack at mark-to-market-accounting." Not being successful in pursuing fair value accounting in Statement No. 12 was the reason Schuetze left the FASB in 1976 (Schuetze, 2006, p. 8).

Both economic forces were most prevalent when the FASB embarked on its conceptual framework project.[2] Although a decision-usefulness objective had been adopted early on, it was not until the late 1970s that the Board moved from the abstract to the concrete and approached reporting of income and recognition and measurement of financial statement elements. Aiming to display economic reality, the Board introduced a new all-inclusive income concept – comprehensive income – which separated operating performance from other results such as holding gains and losses. Comprehensive income would on the one hand have healed the distortion of all-inclusive income introduced by the revised foreign currency translation standard. On the other hand, it would have enabled the Board to measure more financial statement elements at current values without distorting the capacity of earnings as a performance indicator.

When in the 1980s the economic environment became less disruptive, showing the temporary character of the economic forces, the Board became divided on its recognition and measurement project and was unable to decide on a prescriptive approach. Eventually, the FASB issued Statement of Financial Accounting Concepts (SFAC) No. 5 on recognition and measurement that merely described measurement attributes used in accounting practice. Since this project had shown that the current Board's efforts were spent, the FASB retreated from its reporting income project, but carried forward comprehensive income in Concepts Statement No. 5, which included an insufficient rationale for OCI items. Thus, the impact of the 1981 foreign currency translation project, SFAS No. 52, was severe in that it led to a permanent disruption of the all-inclusive income statement, which was

[2] Appendix A provides a depiction of the two economic forces for the period of my study. I thank Jacco Wielhouwer for his suggestion to include these figures.

partly rectified in June 1997 when the FASB issued SFAS No. 130 "Reporting Comprehensive Income".

Three reasons render a joint consideration of exchange rates and inflation necessary: First, both translation of foreign currency financial statements and accounting for inflation are similar accounting procedures in that they change the unit of measure in financial statements while leaving other accounting principles unchanged.[3] Second, the two economic forces are connected via the theory of purchasing power parity. Third, the economic forces occurred at the same time and were so pervasive that they contributed to the "rise of economic consequences" as an argument in the standard-setting debate (Zeff, 1978, pp. 59-60). They had an impact on the FASB's debate on the conceptual framework and help explain the descriptive format of Concepts Statement No. 5.

This article adds to the recent study by Rees and Shane (2012), who conclude that OCI accounting was a result of ad-hoc decisions. By shedding light on how the concept came about, I argue that the FASB did not intend to move away from an all-inclusive income statement and that its rationale for SFAS No. 52 was not unprincipled. However, by abandoning its reporting income project, the Board was unable to provide an adequate conceptual basis for the 1981 foreign currency translation standard with the result that Concepts Statement No. 5 includes only a minimal, ex-post justification for the concept of OCI. Overall, I contribute to the literature by reassessing both SFAS No. 52 and OCI accounting and by showing

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[3] E.g., SFAS No. 52 (para. 114) states that „an analogy may be drawn between the cumulative foreign currency translation adjustment and the difference between equity (net assets) measured in constant dollars and the same net assets measured in nominal dollars."

that not only inflation accounting but also the project on foreign currency translation had an impact on the course and the eventual outcome of the conceptual framework project. Broadly speaking, I demonstrate how the economic environment affects standard setters' deliberations on accounting standards and fundamental concepts.[4]

I proceed by describing the prevalent pre-FASB accounting model, the FASB's first statement on foreign currency translation, i.e. SFAS No. 8, and the early phases of the conceptual framework project.[5] In subsequent sections, I outline the Board's approach to inflation and revising Statement No. 8 and explain how these debates informed and affected the conceptual framework project. I conclude by showing the implications of the debates for subsequent standard setting efforts and providing some afterthoughts for the current debate on a conceptual framework.

4 Confirming the general thrust of my article, Donald Kirk states: "The backdrop of inflation, floating exchange rates and prospects of other vexing valuation problems, some old and many then unknown, made general, understandable and implementable principles for recognition and measurement beyond the reach of the Board I chaired." Communication to the author dated January 27, 2013.

5 This article is not intended to give a comprehensive review of the conceptual framework project (see, e.g., Solomons, 1986; Gore, 1992; Miller, Redding and Bahnson, 1998, ch. 4; Zeff, 1999). Instead, I aim to selectively point out how the projects on foreign currency translation and inflation affected the course and outcome of the conceptual framework project.

2 The Early Debates: Considering Change

2.1 The Pre-FASB Accounting Model

Soon after the SEC was established in 1934, the American Accounting Association (AAA) provided authoritative guidance to the regulator (AAA, 1936), which, along with revisions of and supplements to it, were cited with favor by the SEC's accounting staff (Zeff, 1999, p. 90). The "Tentative Statement of Accounting Principles" established historical cost accounting as well as the all-inclusive income statement:

> "1. The accountant's valuation of physical assets at any given point of time involves the determination of what part of original cost should be written off to reflect consumed, expired, or lost usefulness, and what part should be carried forward as reasonably applicable to future operations. […]
> 8. The income statement for any given period should reflect all revenues properly given accounting recognition and all costs written off during the period, regardless of whether or not they are the result of operations in that period: to the end that for any period of years in the history of the enterprise the assembled income statements will express completely all gains and losses." (pp. 188-9)

When elaborating on the AAA's Statement, Paton and Littleton (1940), which "probably did as much as any single publication to perpetuate the use of historical cost accounting in the U.S." (Zeff, 1999, pp. 90-1), took a similar position. With the exception of Chapter VII, the monograph endorsed historical cost accounting and an all-inclusive income statement. Subsequently, "accounting practice has developed substantially along the lines specified in the monograph" and "rationalization and theory consistent with the monograph […] have been common in authoritative pronouncements" (Storey, 1981, p. 90).

The SEC's commitment to this accounting model blocked standard setters' sporadic efforts to change. The Committee on Accounting Procedure (CAP) favored a current operating performance approach that excluded from net income "items which in the aggregate are materially significant in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period" (Accounting Research Bulletin (ARB) No. 32, "Income and Earned Surplus", December 1947, para. 11). When the Bulletin was published in the January 1948 issue of The Journal of Accountancy, SEC Chief Accountant Earle C. King issued an accompanying letter that read: "Commission has authorized the staff to take exception to financial statements which appear to be misleading, even though they reflect the application of Accounting Research Bulletin No. 32" (p. 25).[6]

The CAP's successor, the Accounting Principles Board (APB), eventually embraced the all-inclusive income statement. In Opinion No. 9 "Reporting the Results of Operations", issued in December 1966, the APB made an exception only for prior period adjustments, which would distort current income due to including items related to prior periods (para. 19). This approach was carried forward by the FASB in Statement No. 16 "Prior Period Adjustment", issued in 1977.

6 ARB No. 35, issued in October 1948, recommended that items excluded from net income be displayed in the surplus statement and not the income statement to avoid confusion about the bottom line, i.e. earnings.

In a similar manner, the SEC stuck to historical cost accounting defying attempts by the CAP and the APB to introduce flexibility in measurement. Zeff (2007) emphasizes the role of the SEC and its Chief Accountants in U.S. standard setting by treating episodes prior to 1972 when standard setting bodies unsuccessfully attempted to depart from historical cost accounting.

2.2 Foreign Currency Translation: The FASB's First Attempt

When the FASB began operations in July 1973, it added to its initial agenda foreign currency translation.[7] As discussed in the February 21, 1974 Discussion Memorandum "Accounting for Foreign Currency Translation",[8] the project meant to give uniform guidance to the diverse accounting practice on translation of foreign currency financial statements.[9] Increased international business activities and floating exchange rates following the 1971 demise of the Bretton Woods system of monetary management likewise made the project necessary.

An important source for the Discussion Memorandum was Accounting Research Study (ARS) No. 12 written by Leonard Lorensen (1972), who proposed a new method for translating foreign currency statements, termed the temporal method.[10] He argued that "a measurement conversion process only changes the unit of measure; it cannot be used to change the attribute measured" (p. 11) and proposed that "the assets and liabilities of foreign subsidiaries be translated in a manner that

[7] The Board's first standard, SFAS No. 1, issued in December 1973, dealt with "Disclosure of Foreign Currency Translation Information".

[8] Appendix B provides a list of relevant FASB documents by time of issue.

[9] The APB had also addressed the issue without proceeding beyond an Exposure Draft. Instead of promoting uniformity, the Exposure Draft fostered the diversity since some companies adopted its approach.

[10] The Board also considered a study by R. MacDonald Parkinson. However, Parkinson (1972) was not as prescriptive as Lorensen (1972) and played a less significant role.

retains the accounting principles used to measure them in the foreign money financial statements" (p. 17). The temporal method thus requires that the translation process follows the underlying measurement principle of the respective item: Assets measured at historical cost would be translated using the historical exchange rate, while assets carried at "current values", e.g. cash, would be translated at the current exchange rate. For Lorensen (1972, p. 48), the treatment of translation adjustments was clear-cut:[11] They were a gain or loss and should be reported in the income statement.

In his comments to the research study, Reed K. Storey, then the director of accounting research at the American Institute of Certified Public Accountants (AICPA), stated that Lorensen's U.S. dollar perspective "is an assumption – a premise – about how those who read financial statements of U.S. companies stated in U.S. dollars see foreign operations of U.S. companies. Another assumption might lead to a different principle of translation" (p. 103). Other than that, Storey supported the study and emphasized its theoretical soundness. Connecting the treatment of translation adjustments to the debate on historical cost accounting, Storey argues (p. 110): "Since losses on foreign debt from changes in foreign exchange rates are exactly the kind of losses that must be recognized under presently accepted conventions, deferring those losses is impossible unless financial accounting is changed significantly. However, talk of changing fundamentally or replacing the accepted historical cost basis of accounting has so far been just that – talk. Historical cost accounting has been criticized harshly, and the need to consider

[11] Lorensen (1972, p. 48) disapproved of the term "translation adjustment": "The change in net assets reported solely in the translated statements is sometimes called a "translation adjustment" – a description that implies the change is the result of some imperfection in the translation process. That description is misleading."

alternatives has been voiced repeatedly. […] Nevertheless, every proposal to change from historical cost is resisted fiercely, and the accounting profession has taken no significant step away from historical cost."

When, on December 31, 1974, the FASB issued the Exposure Draft "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", the document largely followed Lorensen (1972) by proposing the temporal method for translation of financial statements and by requiring translation adjustments to be included in income.[12] In its February 28, 1975 Status Report (No. 22, p. 2), the FASB pointed to the close link between the projects on foreign currency translation and inflation, on which it had issued an Exposure Draft in December 1974 (see below). The Board asked respondents to consider how their views on one project would affect the other project.[13]

In October 1975, with a 6-1 vote, the FASB issued Statement No. 8 "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements". It did not materially differ from the Exposure Draft and was thus a logical and consistent outcome of the prevalent accounting model. The sole dissenter, Robert E. Mays, formerly a Controller at Exxon Corporation, seemingly anticipated the troubles yet to come: "[T]he use of the temporal method with the immediate recognition of the resulting exchange differences as gains and losses will, in the present environment of fluctuating exchange rates, cause erratic

12 It has been proposed that, starting with the Exposure Draft, the FASB provided "mixed signals regarding its favored method" (Ziebart and Kim, 1987, p. 345). The argument suggests that the FASB was at least partly responsible for the ensuing controversy on foreign currency translation.

13 In fact, respondents who did not address the inflation project in their comments received the above-mentioned article from the Status Report and an accompanying letter asking for a supplemental comment letter.

changes in the reported results of companies with significant foreign operations. […] He also has concern that current recognition in income of translation differences produced under the temporal method may induce uneconomic actions by companies to protect against what may be viewed as an accounting exchange exposure, as contrasted with the actual exchange exposure." (p. 12).

Reflecting on Statement No. 8, Raymond E. Simpson, a project manager at the FASB, stated that "the Board concluded that the translation process could not produce a result that is compatible with the expected economic effects of a change in exchange rates without major changes in the present historical cost accounting model" (Simpson, 1981, p. 1). In a similar vein, Burton (1981, p. 64) wrote that "there is little question that of all the statements published by the FASB, the one that is most faithful to the historical cost accounting model, and the one that is most rigorously logical, is Statement no. 8." In its early approach to standard setting, the Board thus employed normative accounting research and aimed to issue conceptually consistent standards in a historical cost accounting framework. Nonetheless, Robert Mays' dissent demonstrates that the FASB had been aware of the limitations of its approach. Giving in to practical concerns would have implied a change in the Board's underlying premises, which it was not yet ready to make.

2.3 The Beginnings of the Conceptual Framework Project

Although the Wheat Committee, which recommended establishing the FASB, did not envision the Board to develop a conceptual framework (Zeff, 1999, pp. 101-2), the Board concluded early on that it would "address itself to the entire hierarchy of financial accounting theory" (Status Report No. 6, November 28, 1973, p. 2). The Board based its consultations on the report of the Trueblood Committee, which had been formed in 1971 to propose fundamental objectives of financial statements to guide the improvement of financial reporting.[14] In its 1973 report, the Committee concluded that "[a]n objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flows to them in terms of amount, timing, and related uncertainty" (*Objectives of Financial Statements*, p. 20). The report "became a kind of blueprint for the [FASB's] conceptual framework project" (Zeff, 1999, p. 101), although the Board initiated its own study and, on December 2, 1976, issued its "Tentative Conclusions on Objectives of Financial Statements". It would take another two years until, in November 1978, Statement of Financial Accounting Concepts (SFAC) No. 1 "Objectives of Financial Reporting by Business Enterprises" was issued establishing the decision-usefulness objective for the Board's standards.[15]

It has been suggested that such an objective promotes a "forward-looking, economic decision-oriented system of accounting", which likely prefers current value accounting (Tweedie and Wittington, 1984, p. 165). While with hindsight this inference seems appealing, the FASB had merely followed the Trueblood Report without committing itself to a particular measurement system. This conclusion is evidenced by the documents issued along with "Tentative Conclusions", in particular "Scope and Implications of the Conceptual Framework Project", which included a section that answered negatively the question "Is Current Value Accounting A Foregone Conclusion?" (pp. 18-9).

[14] For a detailed history and analysis of objectives of financial reporting, see Zeff (2012).

[15] The scope of the Concepts Statement was widened to all financial reporting to encompass a company's entire external communication of accounting information (SFAC No. 1, paras. 5-8). Armstrong (1977, p. 77) reports that only 37 percent of respondents to the Discussion Memorandum supported the decision-usefulness objective.

In the Discussion Memorandum on "Elements of Financial Reporting and Their Measurement", also issued on December 2, 1976, the Board criticized the existing approach to financial reporting, i.e. the revenue and expense view. It disapproved of the "nondistortion guideline" which "may have become the major standard of good matching in the minds of many proponents of the revenue and expense view. That is, the crucial question they ask […] is – Does it distort an enterprise's periodic earnings or the earnings trend?" (p. 47).[16] While an objective criticism of corporate practice was given, the Board shared this view, calling the approach "subjective" and "vague" (p. 47). It frequently alluded to the asset and liability view "to put some boundaries on the resulting balance sheet debits and credits to determine that they are more than just bookkeeping residuals" (Kirk, cited in FASB Viewpoints, June 8, 1979, p. 3).

The Discussion Memorandum presented different concepts of earnings but was faithful to the all-inclusive income concept, designating revenues, expenses, gains and losses as "the components of earnings" (p. 101). It discussed five measurement "attributes" (historical cost, current cost, current exit value in orderly liquidation, expected exit value in due course of business, present value of expected cash flows, p. 193) that had been used or proposed for measuring assets and liabilities but it did not recommend one particular system.[17] In addition, the Discussion Memorandum (pp. 125-9) distinguished the traditional view of maintaining financial capital, as measured by the amount of cash invested by shareholders, from

[16] The nondistortion guideline is described by Herman W. Bevis, a senior partner at Price Waterhouse & Co.: "From among systematic and rational methods, use that which tends to minimize distortions of periodic net income" (Bevis, 1965, pp. 104-7).

[17] The Discussion Memorandum calls "inappropriate" the term "historical cost model" to characterize the prevailing accounting model (p. 194). While acknowledging that accounting practice employed a variety of measurement bases, I continue the use of the term for the sake of convenience.

physical capital maintenance, i.e. the productive capacity of the enterprise. The latter concept was associated with current replacement costs, recognizing holding gains or losses not in earnings, but as capital maintenance adjustments of equity (p. 134). Financial capital maintenance can be combined with any of the five measurement attributes mentioned by the Memorandum and disagreement exists about the timing of recognition of value changes in earnings (p. 126).[18]

Tweedie and Whittington (1984, pp. 164-5) suggest that “the possibility of current value accounting emerges clearly from the Discussion Memorandum.” This impression was also conveyed to others as, e.g., shown by a campaign launched by Professor Robert Mautz, a partner at Ernst and Ernst. With the approval of his employer, Mautz, who earlier had been on the Board’s conceptual framework task force, toured more than sixty chapters of the Financial Executives Institute (FEI) criticizing the Discussion Memorandum, the asset and liability view and current value accounting (Gore, 1992, pp. 94-5). Feeling that Mautz had misrepresented the FASB’s views, Board members gave a number of talks themselves to clarify their approach. The speeches had the same tone: They emphasized that “the historical cost system has served well the need for objective, verifiable information” and stressed the need for “an organized approach to assessing the benefits of any new measurement scheme” (Kirk, cited in Status Report No. 57, December 1, 1977, p. 3).[19]

[18] The Exposure Draft “Financial Reporting and Changing Prices” (para. 59) pointed out that the “vast majority” of respondents to the Discussion Memorandum had preferred the financial capital maintenance concept.

[19] See also the speeches cited in the January 5, 1978, August 4, 1978, and June 8, 1979 edition of FASB Viewpoints.

Overall, the early documents in the conceptual framework project displayed the Board's intent to develop its own prescriptive theory, which it could henceforth follow in the attempt to minimize ad hoc standard setting.[20] Reconsidering their current approach to standard setting and financial reporting, the "FASB created an environment in which major changes could take place" (Miller, 1990, p. 24). This environment was particularly hostile to subjective matching and the nondistortion guideline. By emphasizing the primacy of assets and liabilities, the Board aimed to ensure that accounting presented empirical measures of financial statement items based on actual observations instead of management intent (Miller and Bahnson, 2010, p. 428).[21] Both the decision-usefulness objective and the asset and liability view were misunderstood as being catalysts for current values, although the Board explained that its approach did not preordain current value accounting (Kirk, 1989, p. 90). By contrast, it seemed that at that time historical cost accounting could still be expected to remain as a central pillar of financial reporting. Chairman Armstrong affirmed that "we do not contemplate a major change from the present historical-cost based measurements solely on the basis of this discussion memorandum" (Status Report No. 43, December 17, 1976, p. 2). Instead, responses to the Memorandum would indicate which measurement bases required "more intensive consideration and experimentation before a final conclusion is reached."

[20] Communication from Donald Kirk to the author dated January 27, 2013.

[21] Miller and Bahnson (2010, p. 426) assert that the subsequent SFAC No. 3, issued in December 1980, displayed "the strongest evidence" of the asset and liability view.

3 Challenging the Existing Accounting Model

3.1 Coping with Inflation: Loosening the Grip on Historical Costs

Inflation had been a lingering concern in the United States following World War II such that in 1961 the APB started a project to determine appropriate accounting under inflation. Its accounting research staff drafted ARS No. 6 “Reporting the Financial Effects of Price-Level Changes”, published in 1963. The study argued that accounting for the effects of price-level changes would increase the accuracy of the measurements of accounting numbers and recommended to disclose as supplementary schedules adjusted financial statements based on a general price level index (pp. xi-ii). Gains and losses from recognizing the inflation effect on monetary items would be included in income (p. xii). The study featured a disclaimer that would be common throughout the debate on inflation accounting: “Restatement by means of a single index of the general price level is not a means of introducing replacement costs into the financial statements” (ARS No. 6, 1963, p. xi).

The APB’s Statement No. 3 “Financial Statements Restated for General Price-Level Changes”, which was issued in June 1969, was largely based on ARS No. 6. Being a Statement instead of an Opinion, it was a recommendation rather than authoritative guidance. Indeed, Tweedie and Whittington (1984, p. 43) report that only one company, the Indiana Telephone Corporation, followed the Statement’s recommendations and it had been disclosing price-level data since before the Statement was issued.

In its first year of operations, the FASB likewise perceived a need for price-level data and responded to a sharp increase in the inflation rate, which soon reached levels above 10 percent. A February 15, 1974 Discussion Memorandum was followed by the Exposure Draft "Financial Reporting in Units of General Purchasing Power", issued on December 31, 1974.[22] Neither document advanced conceptually beyond the recommendations of APB Statement No. 3 and ARS No. 6 (Tweedie and Whittington, 1984, p. 43). Following an extended exposure period, the Board announced in late 1975 that it would not proceed with a standard that year because the proposed procedures had to be tested more extensively.[23]

In the meantime, a FEI-sponsored study argued that the usefulness of price-level adjusted financial statements for management decisions "would be marginal at best" suggesting a serious cost-benefit problem (Shank, 1975, p. 9). The study suggested that managers could "*implicitly* factor price level considerations into their interpretation of the historical cost based financial statements" concluding that such information would not change decision-making (Shank, 1975, p. 10).

Preempting further action from the FASB, the SEC on March 23, 1976 issued ASR No. 190 "Notice of Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data". The Release required large firms to disclose in a footnote unaudited replacement cost data for inventories, fixed

[22] Both Discussion Memorandum (p. 6) and Exposure Draft (p. iii) emphasized that price-level statements are based on historical cost and not current value. The consideration of measurement bases, including current value accounting, was said to be within the scope of the conceptual framework project. All documents on inflation accounting discussed alternative measurement attributes as supplementary disclosures such that at the time a deviation from historical cost accounting in the body of financial statements still seemed unlikely.

[23] By then, the FASB knew the SEC's preference for replacement cost data, which had been outlined in an August 1975 rule proposal of what became Accounting Series Release (ASR) No. 190.

assets, cost of goods sold and depreciation charges. The release bore the handwriting of John C. (Sandy) Burton, SEC Chief Accountant since 1972, who was a critic of the FASB's general price-level accounting because it disregarded the uneven effects of inflation on specific sectors and goods. In a speech given on May 30, 1974, Burton had outlined his preferred approach based on replacement cost data (Burton, 1975). Making up for this embarrassment, the FASB receded from its project explaining that "general purchasing power information is not now sufficiently well understood by preparers and users and the need for it is not now sufficiently well demonstrated to justify imposing the cost of implementation upon all preparers of financial statements at this time" (Status Report No. 37, June 4, 1976, p. 1).

By 1978, inflation had further increased and Sandy Burton had been replaced as SEC Chief Accountant by A. Clarence Sampson, who conducted his job in a much quieter way and respected the Board's mandate more fully.[24] The FASB approached the issue again, possibly taking advantage of the lower risk of "friendly fire". It went on to issue an Exposure Draft "Financial Reporting and Changing Prices" on December 28, 1978, which allowed large companies to choose between its favored solution of general price-level accounting, now called constant dollar accounting, and the SEC's approach of current cost accounting, referring to an asset's "value to the business", i.e. its deprival value.[25] The Board embraced a financial capital maintenance concept, according to which "changes in the prices of assets held by the enterprise can be recognized as income" (para. 60). Nonethe-

[24] Sandy Burton at first wanted the FASB to "pre-clear everything with him and his office". The relationship between Clarence Sampson and the Board, by contrast, was one of "mutual respect" (Kirk, 2011, pp. 35 and 37).

[25] On March 2, 1979, the FASB published a supplement to its December 1974 Exposure Draft updating the first Draft to the constant dollar requirements.

less, the FASB contemplated the usefulness of reporting separately the effects of inflation. In the spirit of SFAC No. 1's decision-usefulness objective, the Board considered it "likely that the separation of income from continuing operations and holding gains or losses may provide an improved basis for [financial statement users'] assessment [of future cash flows]" (para. 71). Such a conclusion was likely to have a bearing on the ordering and presentation of the traditional income statement.

While requiring departure from historical cost in supplementary statements, the FASB gave a strong commitment to historical cost accounting in the body of financial statements since historical prices depend on actual transactions and "tend to be capable of independent verification" (para. 3). The FASB – in spite of serious challenges to historical cost accounting – had not bid farewell to the existing approach to measurement. It was alleged that "recently, something close to a consensus has emerged"[26] that "no major changes should be made in the financial statements at this time, but something must be done […] to provide more information about the effects of price changes" (p. i).[27]

When, in September 1979, SFAS No. 33 "Financial Reporting and Changing Prices" was issued with a 5-2 vote, it bore large resemblance to the Exposure

[26] Tweedie and Whittington (1984, p. 166) assert that the Board referred to the written and oral submissions in response to the December 1976 documents as evidence for the consensus.

[27] Likewise, the Board concluded that "a [SFAC] on measurement should not be prepared at this time. Conceptual choices that would change the basic financial statements should not be considered until users and preparers of financial reports have obtained further practical experience with supplementary information based on current measurement concepts and on constant dollar accounting" (para. 52). This statement yields further evidence to the presumption that the Board was not convinced of the superiority of current value measures.

Draft.[28] However, the FASB did away with its either-or-approach and required companies to disclose both constant dollar and current cost data.[29] The Board also withdrew from the financial capital maintenance concept (para. 104) and, as a result, adopted a more neutral term for holding gains and losses, now called increases and decreases in current cost amounts (para. 125). The value changes were to be excluded from income from continuing operations (para. 30), but the two components together would provide a “comprehensive measurement of enterprise performance” (paras. 131-136), foreshadowing the “comprehensive income” concept. Five years after the issuance of SFAS No. 33, the Board was scheduled to review the Statement or, if necessary, amend it earlier (para. 15). The two dissenters criticized the dual approach of the Statement. However, while David Mosso was doubtful of the constant dollar data, Ralph E. Walters criticized the current cost disclosures.

FASB’s Director of Research and Technical Activities, Michael O. Alexander (1981, p. 1) stated that, if considered in context, Statement No. 33 was “the most important change in accounting in several hundred years”, possibly since it expanded use of current value figures, albeit in supplementary disclosures only. However, standard setters, preparers and users were uncertain whether the economic environment was a diversion from normal or a new reality, as can be seen by the Board’s experimental approach to SFAS No. 33, which considerably differed from the days of deductive reasoning based on pre-existing concepts and

[28] Following issuance of Statement No. 33, the SEC phased out ASR No. 190 in October 1979.

[29] The Board had set up task groups, which were to identify special measurement problems in six industries. Whereas banking and insurance were eventually included in the scope of SFAS No. 33, the other industries were exempt from the requirement to disclose current cost data and covered in Statements No. 39 (mining and oil and gas), No. 40 (forest products) and No. 41 (real estate), respectively.

accounting theory. Displaying its pragmatism, the Board made “no pretense of having solved all of the implementation problems” (para. 14). In a similar vein, Chairman Kirk, in an address to the Business Council, appealed to the business community’s “willingness to view our decision not as some form of unwanted regulation but rather as an opportunity to communicate the different effects of inflation on the profits of your businesses. We think we have given you the tools, but the message is up to you” (Kirk, 1979, p. 3).

3.2 Giving in to Pressure: Foreign Currency Translation Revisited

Following issuance of Statement No. 8, preparers and academics launched criticism at both the Board and the Statement.[30] Foremost, it was alleged that the Statement created accounting exposure and ignored economic exposure such that companies engaged in uneconomic actions to avoid volatile earnings. For example, Teck (1976, p. 71) reported that SFAS No. 8 “tends to discourage” hedging inventory because inventory is not exposed to currency fluctuations, but forward contracts are.

In spite of this criticism, the FASB voted 6-1 against reconsidering the Statement in April 1976, when the requirements were effective for less than four months. The Board argued that the objective of accounting was not to minimize the fluctuation of earnings (Status Report No. 36, April 28, 1976, pp. 1 and 3). It also rejected calls to exclude translation adjustments from the determination of income along the lines of SFAS No. 12 “Accounting for Certain Marketable Securities”.

[30] For a review of the criticism in the (business) press, practitioners’ as well as scholarly journals, see Shank, Dillard, Murdock (1979, pp. 95-125). At least one of the authors is strongly opposed to SFAS No. 8 (Shank, 1976), which is why the review may not be objective. However, Statement No. 8 was revised in response to the public opinion such that the review at least shows the extent of the negative reaction.

When criticism did not ebb, the Board in 1977 invited research papers on the economic consequences of accounting standards.[31] The FASB-sponsored research indicated that stock returns were not affected by SFAS No. 8 (Dukes, 1978), but that companies pursued more aggressive risk management and incurred additional cost to avoid an anticipated increase in volatility of earnings (Evans, Folks, Jilling, 1978). A FEI-sponsored study argued that “managers are so committed to the importance of accounting numbers […] that they will undertake actions in the foreign currency area which they know to increase expected costs and risk levels in order to preserve desired relationships in those numbers” (Shank, Dillard, Murdock, 1979, p. 4). The economic environment of floating – possibly volatile – exchange rates amplified these concerns since “the dollar value of foreign currency items on balance sheets and income statements was subject to increased variability with the possible result that net earnings could become more volatile” (Makin, 1978, p. 42).

Responding to a recommendation by the Structure Committee of the Financial Accounting Foundation to experiment with a more formal post-enactment review process, the FASB in May 1978 issued an invitation for public comment on Statements that had been in effect for at least two years (i.e. Statements No. 1-12). The invitation included specific reference to SFAS No. 5 and No. 8 as the most controversial standards so far. The Board received more than 200 letters and 88 percent of respondents expressed concerns with SFAS No. 8 (Van Riper, 1994,

[31] In its May 23, 1977 Status Report (No. 48, p. 2), the Board also requested comments on existing standards. Over the next 18 months, the Board received 20 requests on SFAS No. 8, by far the most on any standard, which asked for interpretation or even reconsideration of the Statement.

p. 32). As a consequence, SFAS No. 8 was given particular emphasis in the subsequent review.

Nevertheless, public speeches of Board members implied that they were not entirely certain whether the public criticism was warranted. Oscar S. Gellein (1978, p. 2) called it “a serious charge” that management was taking uneconomic actions in response to some of the Board’s standards. Chairman Kirk struggled with the need to represent in financial statements economic reality, which he called “elusive” (FASB Viewpoints, January 26, 1978, p. 3). Referring to the reaction to SFAS No. 8, he criticized managements’ attitude of trying to avoid volatile earnings: “It is only human nature […] to look for accounting methods that will tend to mitigate the effects of uncontrollable but very real economic events. The end result is that the current financial statements, those which are to tell the story of current performance, will not include a peak or a valley but rather will show what a manager honestly believes to be his “true” earnings. This approach to accounting for uncontrollable events is characteristic of one widely held conceptual view of earnings that is often called the “nondistortion” view” (FASB Viewpoints, August 4, 1978, pp. 4-5).

Although being somewhat hesitant, the FASB voted unanimously to reconsider SFAS No. 8, adding the project to its agenda on January 31, 1979. The project was classified as high-priority and was assigned more staff resources than any other project except the conceptual framework (1979 Annual Report of the FASB, February 12, 1980, pp. 5-6). As early as June 1979 did the Board conclude that the current exchange rate was to be used and that translation adjustments should be excluded from income. Chairman Kirk emphasized that “the members of the

FASB recognize, I assure you, that corporate executives have a distaste for earnings volatility – particularly and understandably for earnings fluctuations caused by events beyond their control" (FASB Viewpoints, November 9, 1979, p. 2). The solution to the criticism seemed driven by pragmatism.

On August 28, 1980, the Exposure Draft "Foreign Currency Translation" was issued featuring the functional currency, i.e. "the primary currency of the economic environment in which the entity generates and expends cash" (para. 8). It required use of the current rate (para. 9) and translation adjustments to be recorded in a separate component of stockholders' equity. The Board had given in to requests along these lines and even admitted it had done so by citing the most frequently made recommendations regarding changes to Statement No. 8 (para. 46). Possibly, the Board aimed to show it had taken care of its constituency's concerns.

Three Board members dissented to the Exposure Draft, inter alia, because the proposed statement "has the potential to reduce the credibility of financial reporting" (para. 102.d.).[32] For the dissenters, the Exposure Draft was a capitulation of the FASB to the business community. They "recognize the extreme difficulty, if not impossibility, of developing standards for foreign currency translation that are conceptually consistent, practical to implement, and easy for users to understand" (para. 104). Calling the subject "the most complex and most controversial one that the Board has faced", Chairman Kirk, who – along with Frank E. Block and Robert A. Morgan – was later identified as one of the dissenters, displayed frustration when describing the challenges of the project and the perceived inadequacy

[32] In 1977, the voting requirement was changed from a supermajority (5-2) to simple majority (4-3).

of accounting to portray economic reality: “The limits of accounting, the need for evenhanded solutions to accounting problems, and the harshness of the reality of floating exchange rates probably make popularity irreconcilable with concepts and reality” (Status Report No. 109, December 30, 1980, p. 2).

While rejecting requests for an extended exposure period, as asked for by the FEI’s Committee on Corporate Reporting, the FASB decided to reexpose the matter since comments received required changes of sufficient magnitude. A revised Exposure Draft was issued on June 30, 1981, inter alia, including changes regarding the determination of the functional currency. The second draft included more detailed basis for conclusions and described that the assenters to the Statement had two conceptual views of translation adjustments. The first view regarded the adjustments as reflecting an economic effect of exchange rate changes (para. 111), whereas the second view considered them a mechanical by-product of the translation process (para. 112). The Board did not consider it necessary to conclude on one view because “both views exclude these adjustments from net income and include them in equity” (para. 110). Of the seven Board members, only four assented and these members had two conceptually different views, showing the controversial nature and, possibly, lacking theoretical justification of the solution. Despite some misgivings concerning the practical impact of SFAS No. 8, it was theoretical arguments that had produced the first foreign currency translation standard. The developments in the course of the second project show a considerable change in the Board’s attitude reflecting the rise of economic consequences (Zeff, 1978) and, to a degree, the changing premises of financial reporting.

The dissents indeed pointed, inter alia, to the lacking relationship to preexisting fundamental concepts: “The dissenters believe the functional currency perspective […] challenges and rejects the U.S. dollar perspective that underlies existing theories of […] historical cost and capital maintenance, […] and inflation accounting. […] The rejection of the U.S. dollar perspective has ramifications far beyond this project and was unnecessary in a translation project.” (para. 150). The dissenters criticized the renunciation of traditional accounting premises by explaining that “[the Statement] remeasures the U.S. dollar equivalent cost while the item is held […] and treats that remeasurement as a translation adjustment, seldom if ever reported in net income. The implication of that is not only to change income measurement concepts in the basic financial statements but also to modify the measurement of changes in current costs (sometimes referred to as holding gains and losses) in Statement 33” (para. 151). The vehemence of the dissent gives testimonial to the controversial debates taking place concerning changing premises of accounting theory. Giving in to pragmatism also implies that the Board was guided by its decision-usefulness objective when it issued Statement No. 52 “Foreign Currency Translation” by a 4-3 vote on December 8, 1981 without material changes to the revised Exposure Draft.[33]

The FASB subsequently sponsored three research studies to examine Statement No. 52. Evans and Doupnik (1986a) concluded that the functional currency method was being applied according to the Statement’s objective. Evans and Doupnik (1986b) found that firms exerted less effort on exchange risk management, which respondents to their survey attributed to factors other than SFAS No. 52.

[33] Following issuance of SFAS No. 52, Statement No. 33 on inflation accounting needed to be adapted to reflect the functional currency approach, which was done by issuing SFAS No. 70 “Financial Reporting and Changing Prices: Foreign Currency Translation” in December 1982.

Griffin and Castanias (1987), who interviewed users of financial statements, concluded that most analysts were "better off" with SFAS No. 52, although some analysts indicated that earnings quality had increased. An FEI-sponsored study by Arnold and Holder (1986) suggested that "SFAS No. 52 has contributed substantially to quieting the controversy […]. Measured against the criterion of general acceptability, the standard must be considered a success" (p. viii).

Overall, it seems that companies had not handled well the new regime of floating exchange rates following the demise of the Bretton Woods monetary system. The volatility of exchange rates impeded managers in their attempts to smooth earnings or present the expected income. When the Board reacted to the widespread criticism and changed reporting requirements, it not only gave up its commitment to traditional accounting premises, as evidenced by the departure from an all-inclusive income statement beyond the limited scope of SFAS No. 12. To a degree, it also gave up control over the standard setting process.

3.3 The Trouble Ends: A Declining Inflation Rate

On January 6 and 7, 1983, the FASB held a research conference in White Plains, New York, on the usefulness of inflation-adjusted disclosures. Several of the 15 research projects that were presented indicated that the investment community made only limited use of the changing prices disclosures (Freeman, 1983, p. 1). Nonetheless, it was contended that current cost data would eventually become more useful. Constant dollar information was viewed less optimistically.

In the course of its scheduled review, the FASB in July 1983 appointed a task force and, on December 27, 1983, issued an Invitation to Comment. The approximately 400 responses suggested that both number of users and extent of use were limited suggesting a cost-benefit problem of the supplementary information (Status Report No. 159, August 20, 1984, p. 1). Possibly, the declining rate of inflation contributed to this assessment. After having peaked at 13.5 percent in 1980, inflation declined to 3.2 percent in 1983.

While deciding to continue the changing prices disclosures, the Board in November 1984 issued SFAS No. 82 “Financial Reporting and Changing Prices: Elimination of Certain Disclosures”. Following the responses received earlier, the Statement eliminated the requirement to disclose constant dollar information, which had shown to be of limited use. In addition, an Exposure Draft was issued in December 1984 to combine the remaining pronouncements in one standard. Respondents to the Draft recommended that the supplementary disclosures be discontinued altogether. In view of these comments, the Board refrained from issuing a Statement, but decided to continue existing requirements, i.e. disclosure of current cost information, and to undertake a major project to improve the usefulness of present requirements (Status Report No. 171, November 8, 1985, p. 1).

Only in mid-1986 did the FASB change its views. Although wanting to continue its course of action, the Board acknowledged that the rate of inflation justified neither disclosure of current cost data nor a major project on inflation accounting (Status Report No. 177, July 7, 1986, p. 6). In December 1986, it issued Statement No. 89 “Financial Reporting and Changing Prices” making the supplementary disclosures optional (para. 3). While following the concerns of the business community, the Statement was issued with a 4-3 vote only. The dissenters – David Mosso, Raymond C. Lauver and Robert J. Swieringa – believed that the main thrust of Statement No. 33, i.e. the fact that inflation distorts historical cost-based information, remained unchanged. They argued that the Board would be asked again for supplementary disclosures when inflation rose. Such efforts would be as difficult, time-consuming, and costly as the development of Statement No. 33, which was why they preferred to devote adequate resources to the project now.

4 Implementing Change in the Conceptual Framework?

4.1 Towards a New Income Concept

During most of the conceptual framework project, both volatile exchange rates and high inflation seemed to represent a new economic reality which accounting had to cope with and which challenged the prevalent accounting model. Chairman Kirk welcomed the coincidence of the Changing Prices Exposure Draft with the reconsideration of foreign currency translation and the project on elements of financial statements as “a formidable task but also an extraordinary opportunity to set the course for future standards” (FASB Viewpoints, June 8, 1979, pp. 3-4). Both changing prices and foreign currency translation projects were to employ common definitions of financial statement items and could thus inform the standard setter on the definition of financial statement elements.

This striving for conceptual purity was apparent in the Discussion Memorandum “Reporting Earnings”, issued on July 31, 1979, in which the need for a consistent treatment of elements of earnings was stressed (p. 1). The Memorandum employed a “broad and all-inclusive” (p. 3) working definition of earnings and focused on the reporting of earnings without dealing with measurement aspects (p. 4). Inter alia, it debated a separate reporting of certain components of earnings, e.g. in a multiple-step income statement to reduce the emphasis on the “bottom line” (p. 79), and the exclusion from the earnings statement of some revenues, expenses, gains, and losses, which could be shown as direct adjustments to equity (p. 80). Alluding to the Changing Prices Exposure Draft, the Discussion Memorandum (pp. 71-2) suggested the separate reporting of holding gains from earnings, but deferred the issue until experience had been gained with supplementary schedules before introducing such a requirement in the body of financial statements. Being a Discussion Memorandum, the document suggests that the issues discussed were merely ideas on which the Board sought comments instead of tentative conclusions. However, the frank discussion signifies that by mid-1979 changes to the conventional earnings statement were seriously considered.[34]

The discussion developed towards a roughly defined concept in the December 28, 1979 Exposure Draft "Elements of Financial Statements of Business Enterprises". The Exposure Draft introduced the term "comprehensive income", which in Concepts Statement No. 3, issued in December 1980, was defined as "the change in equity (net assets) of an entity during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners" (para. 56). Both the 1979 Exposure Draft (para. 37) and SFAC No. 3 (paras. 56-7) emphasized that the Board had not decided on its preferred capital maintenance concept. Thus, although comprehensive income implied a return on financial capital, the Board left earnings undefined or "reserved" for "possible use to designate a different concept that is a component part of – that is, is narrower than or less than – comprehensive income" (Exposure Draft, para. 37).

Although support for change was wavering either due to indecision or disagreement, the FASB embraced a new all-inclusive concept – comprehensive income –, defined as the enhancement of wealth, possibly separating operating performance,

[34] The Memorandum also cited user concerns as an affirmation of its position. The Financial Analysts Federation had commented on the December 19, 1977 Exposure Draft: "[N]et income determined on an all-inclusive basis contains too much "noise". […] Hence investors usually will consider underlying earning power from continuing activities as a more meaningful concept of income" (p. 8).

i.e. earnings, from holding gains. The missing piece for such a concept was the decision on a capital maintenance concept, which was said to be part of a separate project. Depending on earnings being a return on physical or financial capital, meaning and appropriate display of earnings could change. Accordingly, the difference between comprehensive income and earnings were “perhaps “capital maintenance adjustments””, which in that case would become a separate element of financial statements (Exposure Draft, para. 37). SFAS No. 33, which was issued three months prior to the Exposure Draft, similarly represents the status quo of the Board’s deliberations. One of the objectives of the Statement is the “assessment of enterprise performance”, which distinguishes operating performance from the effect of changing prices. Such a notion was in line with the comprehensive income concept.

Explaining the Board’s ongoing discussions, Bryan Carsberg, Academic Fellow and Assistant Director of Research and Technical Activities and “largely responsible for SFAS No. 33” as well as some of the conceptual framework documents (Gore, 1992, p. 112), stated that, by including all changes in net assets apart from transactions with owners, the new comprehensive income concept was based on financial capital maintenance. In addition, several Board members believed that the concept needed to be applied in a manner that recognized the impact of inflation (Carsberg, 1981, p. 1).

“Intermediate components” of comprehensive income could be reported, e.g. to distinguish central operations from results of other kinds. To do so, the Board retreated from the term earnings, which “has come to be regarded in current practice as representing a key aspect of performance. Consequently, to label one component as earnings might be to invite an excessive emphasis on that component. […] Several members of the Board attach importance to the disclosure of a component called operating income or operating earnings. However, the Board believes that it should not describe such a component as earnings alone but rather give each component a fully descriptive label" (Carsberg, 1981, pp. 3-4).

The November 16, 1981 Exposure Draft "Reporting Income, Cash Flows, and Financial Position of Business Enterprises" displayed considerations along the lines of Carsberg's remarks, while reaffirming the Board's preference for financial capital maintenance. The FASB gave examples of components of comprehensive income that could be reported as sub-totals without developing specific definitions for these components:

a. Income from continuing central operations for the period,

b. Income from discontinued operations,

c. Income from peripheral or incidental transactions,

d. Income from price changes, i.e. holding gains (para. 151).

The list was described as illustrative and not exhaustive, emphasizing that the Board's approach was not very prescriptive. Only hinting at the direction the FASB was contemplating, the wording suggests indecision and controversy, which the Board may have intended to solve by referring the issue to its constituents.

Nonetheless, the Board continued on its way to a new income concept by calling information based on historical prices "not sufficient for all uses of financial reports". Current exchange prices "may need to be provided either in the primary financial statements or as supplementary information" (para. 12), which was a considerable advancement over earlier commitments to historical cost accounting. However, by retreating from the concept of earnings, the FASB provoked the dissent of an unnamed Board member, likely John W. March, who, in Concepts Statement No. 5, made clear his aversion to comprehensive income and his preference for physical capital maintenance. The dissenter was "concerned that this all-encompassing concept of income will cause misunderstanding about the levels of enterprise performance, return on investment, and profitability" (para. 183). By defying the Board's strive for unanimity on the framework documents (Kirk, 1989, p. 100), the opposition to the Exposure Draft showed that there was a seed of doubt within the Board that would soon grow to outright confrontation.

The extent of the conflict could, however, not be foreseen. Reed K. Storey, Assistant Director of Research and Technical Activities and "the real author of much of the conceptual framework" (Gore, 1992, p. 113), indicated widespread agreement when he captured the sentiment at the beginning of the 1980s:

> "It was a mode of thought that made "matching" into a religion, a doctrine sufficient to justify some highly questionable procedures. It made accounting results much more a matter of opinion and judgment than they need to be. […] First, I think the handwriting is already on the wall for the present model (which is often mislabeled "historical cost accounting") because, among other things, it can't cope with everyday complications, such as changing prices and fluctuating foreign exchange rates. […] Moreover, even if the weaknesses of deferring costs are magnified enough for all to

> see, as they are by changing prices or fluctuating foreign exchange rates, we are more inclined to attempt to patch up the existing model than to admit that it is the basic source of our problems. […] I expect changes in the existing model to be evolutionary, perhaps over a long time. The conceptual framework won't cause those changes – they are already inevitable. But the concepts can make clear the reasons for the changes, guide the changes that need to be made, and make the process of change orderly and consistent rather than ad hoc and potentially inconsistent" (Storey, 1981, pp. 3-5).

By harshly criticizing existing practice, Storey described the FASB's steering away from preexisting fundamental premises. The new income concept would rightly take into account the prevalent economic reality. By separating operating performance from changes in net assets, the effects of rising prices and fluctuating exchange rates could be excluded from the former and, via capital maintenance adjustments, shown in comprehensive income. Thus, the appeal of comprehensive income was that the two economic forces would be accounted for in a consistent manner, as had been intended by the Board. Possibly, the concerns regarding SFAS No. 8 had shown the need of modifying the traditional income statement towards a layered presentation of income components. Alternatively, it was that concept on the horizon that encouraged the FASB to exclude foreign currency translation adjustments from earnings in SFAS No. 52.

4.2 Stopping Short of Change

While seeking consensus among Board members, the FASB was prepared for opposition from other sides and expected that "changes, no matter how inevitable or needed, will be resisted. […] That resistance is natural and, within limits, healthy. […] Resistance to pronouncements commonly results in better pronouncements, and FASB's due process procedures are specifically intended to assure that the necessary skepticism is heard" (Storey, 1981, p. 5). Obstacles to the remaining major project on recognition and measurement would turn out to be largely internal (Kirk, 1989, p. 100).[35]

When, in 1982, the rate of inflation declined considerably, "counterreformation made its appearance known during the recognition and measurement phase of the [conceptual framework] project" (Miller, 1990, p. 28). Had the Board been paving the way for a new income concept that would have allowed larger consideration of current values, it now became apparent that at least some of the Board members had second thoughts regarding the path they were on. Expecting large rates of inflation to be a new economic reality, they seemed to perceive a need to change accounting, as evidenced by Statement No. 33 being "the testing ground for the application of the current cost system [and] for the validity and utility of the concept of physical, rather than financial, capital" (Kirk, 1988, p. 16). When inflation started to appear as a temporary factor, the Board members, who now decidedly examined measurement, found that current value accounting was no panacea.

[35] The two projects on recognition and measurement had been combined since they were considered inseparable (e.g. Status Report No. 132, July 13, 1982, p. 3).

FASB's Director of Research and Technical Activities, Michael O. Alexander (1982, p. 5) still warned of the consequences of ignoring changing prices and stressed the need to reflect "important price change events". He added that current values "will only gain acceptance as we become more comfortable about their reliability and more convinced of their relevance", which was an early mention of current values trading off between the qualitative characteristics of relevance and reliability. The statement also implies that the macroeconomic environment had driven the FASB towards greater consideration of current values, contributing to the project developing a course of its own. Referring to Horngren (1981), one suspects that the disruptive economy had aligned the Board members' individual frameworks. Now that the economy had calmed, some Board members refrained from too revolutionary changes.[36] Perhaps it was the prospect of current values in the body of the financial statements, instead of supplementary schedules, that made some of the Board members ardent defenders of the status quo. By the end of 1982, the Board was split into two groups: Frank E. Block, John W. March and Robert A. Morgan favored the existing historical cost framework, being "very recalcitrant" and "hesitant about saying anything favorable about [what later became known as] fair valuing" (Kirk, 2011, p. 39). David Mosso, Robert T. Sprouse and Ralph E. Walters, by contrast, advocated a more flexible approach. Donald J. Kirk, while somewhere between the groups, tended to side with the latter position but declined joining either, producing stalemate in October 1982.[37]

[36] Gore (1992, pp. 105-10) describes in detail the events that led to the issuance of SFAC No. 5.

[37] The issue of current prices had been a constant part of the conceptual framework debate. Discussing Board members' views at a July 26, 1978 Board meeting, Gellein (1992, pp. 197-8) asserts that the Board was equally divided in members who thought that historical cost "should survive indefinitely", members who thought that "value-based accounting was the accounting of the future" and members who thought that "historical cost would survive indefinitely but that the time was right for thorough consideration of the merits of value-based accounting."

The March 2, 1983 Status Report (No. 140, pp. 3-4) emphasized that the debate was about “the circumstances in which [Board members] would recognize current prices as alternatives to historical costs” instead of an unconditional and complete turn towards current value accounting: “No member of the Board (or staff) favors reporting only historical costs or only current prices in all circumstances.” The Board members’ views on recognition “closely parallel[ed]” their views on the nature and meaning of income as revealed in the debate on the November 1981 Exposure Draft, which “can be oversimplified as the difference between “earnings” and “comprehensive income””. While acknowledging this interrelationship, the Board attributed more significance to the recognition and measurement project and deferred deliberations on reporting income “until it has made basic decisions about recognition and measurement”. It seemed that, instead of a comprehensively defined concept, a piecemeal solution had become more likely.

By that time, the first results of the changing prices experiment had come in showing that users did not find the supplementary disclosures useful. Inflation had ebbed to a level below 5 percent. As a result, moving towards more flexibility in measurement became less important and a solution was nowhere near. When Professor Robert Mautz was brought in by the Board members favoring the status quo, it appeared that accounting would not see major changes. However, neither Mautz’s approach to build on existing Concepts Statements nor the one by Timothy S. Lucas, a project manager, to help each Board member state their preferred view succeeded. In September 1983, Mautz suggested that the Board admit that it could not agree (Gore, 1992, p. 108). In the end, a subcommittee consisting of

Victor H. Brown, Robert T. Sprouse and Ralph E. Walters was set up to seek common ground.[38]

On December 30, 1983, the Board issued an Exposure Draft "Recognition and Measurement in Financial Statements of Business Enterprises" by unanimous vote. SFAC No. 5 followed one year later, in December 1984, eventually supporting financial capital maintenance (para. 45). Although being a "modest improvement" (Solomons, 1986, p. 122), the Concepts Statement continued the main thrust of the Exposure Draft by being a descriptive rationalization of corporate practice without recommending one measurement basis.[39] SFAC No. 5 merely named those bases that were currently in use: historical cost, current (replacement) cost, current market value, net realizable value and present value of future cash flows (para. 67). The only measurement guidance SFAC No. 5 gave was "a carefully worded proposition" (Zeff, 1999, p. 114), which represented "extremely weak guidance" (Storey and Storey, 1998, p. 159), but had been "a major concession to the Board members who favored more market value accounting" (Mosso, cited in Zeff, 1999, p. 115): "Information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information" (para. 90). The statement had been phrased by John W. March who dissented to SFAC No. 5 because the Statement did not commit itself to a historical cost framework. March believed that the paragraph would prevent current values from ever being introduced in financial statements since, in his opinion, current values would never be more relevant than his-

[38] Victor H. Brown had replaced Robert A. Morgan on January 1, 1983.

[39] The Board "left further conceptual guidance on recognition and measurement to come from future standard setters" since "the then FASB was spent." Communication from Donald Kirk dated February 19, 2013.

torical cost information.[40] In his dissent to SFAC No. 5, March also opposed the comprehensive income concept as defined in SFAC No. 3, giving "a full blast endorsement of existing practices, meaning in large part historical cost and matching" (Kirk, 2011, p. 39). Since he had earlier agreed to Concepts Statement No. 3, his "retroactive dissent" (Storey and Storey, 1998, p. 153) suggested that "he did not realize the full implications of what he was doing at the time" (Gore, 1992, p. 103). The economic environment as well as the Board's striving for unanimity on the conceptual framework likely added to March's earlier actions.

With regard to a changing income concept, the FASB decided against following up on its 1981 Exposure Draft and deferred this issue to future standard setters: "The Board expects the concept of earnings to be subject to the process of gradual change or evolution that has characterized the development of net income. Present practice has developed over a long time, and that evolution has resulted in significant changes in what net income reflects, such as a shift toward what is commonly called an "all-inclusive" income statement" (para. 35). The traditional income statement had been sustained, although, ironically, not in an all-inclusive form due to translation adjustments and value changes of certain marketable securities being excluded from earnings. The Board indicated that "perceptions about characteristics such as realizability and volatility" help explain why these items are excluded from income (para. 46). Such practice appears ad-hoc and stands in stark contrast to the objective and consistent approach the Board had been aiming at. The subjective reasoning rather appeared as a minimal ex-post justification that

[40] This fact was provided to the author by Jim Leisenring in a communication dated January 17, 2013.

was along the lines of the nondistortion guideline, against which the Board had launched major criticism.

A number of reasons have been advanced for the Board coming short of a prescriptive recognition and measurement statement.[41] It has been suggested that the project had not been planned properly (Gore, 1992, pp. 43-4) and that the political nature of standard setting had not sufficiently been taken into account. In particular, when Roger Smith in 1981 became chairman of both General Motors and the Accounting Principles Task Force of the Business Roundtable, it seemed that lobbying became a major factor in standard-setting debates (Van Riper, 1994, p. 119). Companies were not willing to accept something other than the status quo and lobbied according to their long-standing fear that the asset and liability view would open the door for current values (Miller, 1990, p. 28). Likely, Board members who had leaned towards the status quo saw themselves confirmed by companies' actions.[42]

It also appears that the Board had underestimated the extent of the changes it had been contemplating in that they would have revolutionized the income statement and more widely considered current values in the body of financial statements. Only when the FASB moved to concrete implications of abstract concepts, i.e. recognition and measurement, and when inflation declined did the Board members' views spark more controversy and prove an insurmountable hurdle. Seemingly unable to take great leaps, financial reporting turned out to evolve much

[41] See Zeff (1999, pp. 119-25) for an assessment of the conceptual framework project and Storey and Storey (1998, pp. 158-60) for an evaluation of SFAC No. 5.

[42] Jim Leisenring, then the Director of Research and Technical Activities, denies that companies' lobbying activities were "more than normal" during the framework project. Communication dated January 17, 2013.

slower than had been expected. Had inflation remained on its previous level, chances for a prescriptive Concepts Statement may have been higher. Likewise, it seems compelling that current values might also have been more widely accepted, although it can only be speculated whether the SEC, in light of its long-standing support of historical cost accounting, would have accepted current values in the body of financial statements.

In light of the difficulty with which SFAC No. 5 was issued, the Board refrained from attending to the reporting income project such that the debate on comprehensive income had been addressed insufficiently. Anthony (1987, p. 76) commented: “Comprehensive income is a meaningless term. I have not seen it before [the conceptual framework project] and I doubt that I will see it again.” SFAC No. 5 carried forward both concepts of earnings and comprehensive income and introduced a statement of comprehensive income (para. 30) as a “concession to those Board members and constituents who wanted the conceptual framework to endorse a greater use of current market values” (Miller, Redding and Bahnson, 1998, p. 113). Comprehensive income thus persisted as an incoherently introduced concept. It was only in June 1997 that the FASB, at the request of users, readdressed the sole reminder of the envisaged concept in SFAS No. 130 “Reporting Comprehensive Income”.

5 Conclusions

In this article, I explain that two economic forces, namely volatile exchange rates and inflation, challenged the prevalent accounting model and informed the debate on the conceptual framework. The Board was contemplating a new all-inclusive income concept – comprehensive income –, which could have separated operating performance from holding gains. Although the 1981 Exposure Draft on Reporting Income did not take a very prescriptive stand, such a model could also have incorporated larger consideration of current values. When the economic forces turned out to be temporary in nature and the FASB considered its recognition and measurement project, some of the Board members blocked any deviation from the status quo. As a result of its spent efforts, the Board abandoned the reporting income project and SFAC No. 5 became the deficient conceptual home for OCI accounting. The disruption of the all-inclusive concept, which had been introduced willingly in SFAS No. 52 with the prospect of being healed ex-post in the reporting income project, became a permanent feature of GAAP, making OCI an unprincipled accounting concept.

Previous authors have pointed to a sea change in the 1970s but have largely focused on the process of standard setting. Solomons (1978) discussed the politicization of accounting, whereas Zeff (1978) pointed to economic consequences being a new argument in the standard setting process. In assessing the FASB's first ten years, Paul A. Pacter (1983), then Executive Assistant to the FASB Chairman, suggests that the end of 1977 was a dividing line between two "eras" of the Board. My article supports Pacter's (1983) assessment with respect to accounting models. It was at that time that the FASB changed its views on foreign currency translation and regained standard setting authority on inflation accounting after the SEC had preempted earlier actions by the Board. Responding to the pervasiveness of the economic forces, the FASB acknowledged departure from an all-inclusive income statement and historical cost accounting as alternatives for future accounting standards.

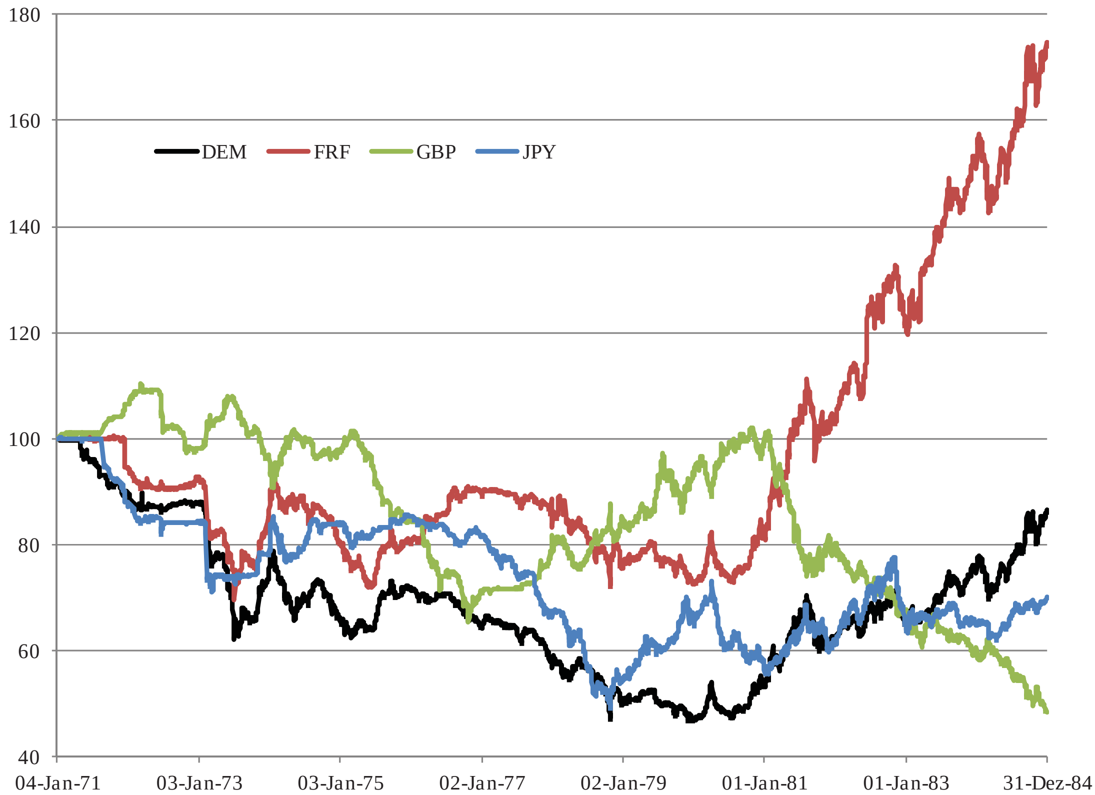
The year 1983 may be seen as a similar dividing line in that the FASB's conceptual framework project came to an end, at least for the time being. The Board had come short of issuing a prescriptive recognition and measurement statement and abandoned its reporting income project. The resulting deficiency of the earnings and comprehensive income definitions as well as the limitations of the measurement section exposed subsequent standard setting efforts to other forces, as evidenced by future comprehensive income requirements being the result of ad-hoc decisions (Rees and Shane, 2012) and political pressure (e.g. Johnson and Swieringa, 1996). By contrast, the experience with SFAS No. 8 emphasized that adhering to preexisting concepts makes accounting vulnerable to practical concerns and reduces standard setting flexibility. The advantage of looser fundamental concepts, and possibly the decision-usefulness objective, is demonstrated by the fact that the Board has been able to use the concept of OCI, e.g. in the case of pensions, to recognize current measures of assets and liabilities in financial statements that otherwise would have appeared in footnotes at best.[43] Thus, a coherent system of fundamental concepts may, on the one hand, help to develop conceptually consistent standards. On the other hand, a system that is too tightly knit around concepts may preempt a solution that is widely accepted and provides re-

[43] Tim Lucas, then a project manager and later FASB's Director of Research and Technical Activities, provided this fact to the author in a communication dated January 17, 2013.

medy to a widespread concern. While it can be hoped that a revision of the Concepts Statements, which have survived largely unchanged, will be conducted in a less disruptive economic environment that affects the course of the debate, the episode narrated in this article emphasizes the need for a coherent, but nonetheless flexible, conceptual framework.

Appendix A: Major Exchange Rates and Rate of Inflation[44]

Panel A: Daily Exchange Rates of the U.S. Dollar against Major Currencies



Note: The time period spans Jan 4, 1971 through Dec 31, 1984. The series are indexed by setting the first data point, Jan 4, 1971, to 100 for each currency (DEM = German Mark; FRF = French Franc; GBP = British Pound; JPY = Japanese Yen). Source: Federal Reserve Bank, accessed April 2, 2013.

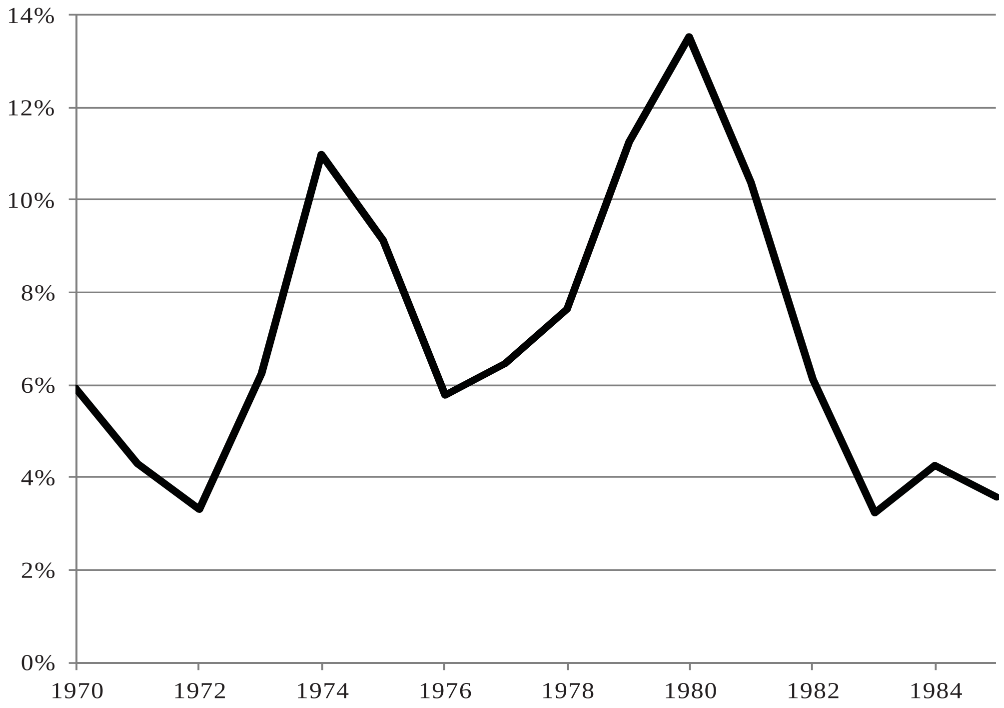
Panel B: Descriptive Statistics of Daily Exchange Rates

	Mean	Std.Dev.	Min	Max
DEM	2.4960	0.4646	1.7080	3.6450
FRF	5.3691	1.3464	3.8462	9.6525
GBP	2.0344	0.3686	1.1580	2.6440
JPY	262.3479	40.5131	177.0500	358.4400

Note: Panel B is based on the data points included in Panel A (DEM = German Mark; FRF = French Franc; GBP = British Pound; JPY = Japanese Yen).

[44] I thank Jacco Wielhouwer for his suggestion to include these figures.

Panel C: Annual Rate of Inflation from 1970 to 1985 based on Consumer Price Index



Note: The figure depicts the annual rate of inflation in the United States based on the consumer price index (all items, all urban consumers). Source: Bureau of Labor Statistics, accessed April 2, 2013.

Appendix B: Relevant FASB Documents by Time of Issue

Date	Project	Document	Title
Feb 15, 1974	Inflation	DM	Reporting the Effects of General Price-Level Changes in Financial Statements
Feb 21, 1974	Foreign Currency	DM	Accounting for Foreign Currency Translation
June 6, 1974	Framework	DM	Consideration of the Report of the Study Group on the Objectives of Financial Statements
Dec 31, 1974	Inflation	ED	Financial Reporting in Units of General Purchasing Power
Dec 31, 1974	Foreign Currency	ED	Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements
Oct 1975	Foreign Currency	SFAS No. 8	Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements
Dec 2, 1976	Framework	n/a	Tentative Conclusions on Objectives of Financial Statements of Business Enterprises
Dec 2, 1976	Framework	n/a	Scope and Implications of the Conceptual Framework Project
Dec 2, 1976	Framework	DM	Elements of Financial Statements and Their Measurement
Dec 29, 1977	Framework	ED	Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises
Nov 1978	Framework	SFAC No. 1	Objectives of Financial Reporting by Business Enterprises
Dec 28, 1978	Inflation	ED	Financial Reporting and Changing Prices

Mar 2, 1979	Inflation	ED	Constant Dollar Accounting
July 31, 1979	Framework	DM	Reporting Earnings
Aug 9, 1979	Framework	ED	Qualitative Characteristics: Criteria for Selecting and Evaluating Financial Accounting and Reporting Policies
Sep 1979	Inflation	SFAS No. 33	Financial Reporting and Changing Prices
Dec 28, 1979	Framework	ED	Elements of Financial Statements of Business Enterprises
May 1980	Framework	SFAC No. 2	Qualitative Characteristics of Accounting Information
Aug 28, 1980	Foreign Currency	ED	Foreign Currency Translation
Dec 1980	Framework	SFAC No. 3	Elements of Financial Statements of Business Enterprises
Dec 15, 1980	Framework	DM	Reporting Funds Flows, Liquidity, and Financial Flexibility
June 30, 1981	Foreign Currency	ED	Foreign Currency Translation
Nov 16, 1981	Framework	ED	Reporting Income, Cash Flows and Financial Position of Business Enterprises
Dec 8, 1981	Foreign Currency	SFAS No. 52	Foreign Currency Translation
Dec 30, 1983	Framework	ED	Recognition and Measurement in Financial Statements of Business Enterprises
Nov 1984	Inflation	SFAS No. 82	Financial Reporting and Changing Prices: Elimination of Certain Disclosures
Dec 1984	Framework	SFAC No. 5	Recognition and Measurement in Financial Statements of Business Enterprises
Dec 1986	Inflation	SFAS No. 89	Financial Reporting and Changing Prices

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III.

The Conceptual Framework's (In-)Adequacy for Standard Setting

Manuscript B.

Dr. Sebastian Hoffmann
Assistant Professor
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: sebastian.hoffmann@hhl.de
tel. +49 (0) 3 41 – 9851 708

Dominic Detzen
Research Associate
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: dominic.detzen@hhl.de
tel. +49 (0) 3 41 – 9851 670

III. The Conceptual Framework's (In-)Adequacy for Standard Setting

1 Introduction 80
2 Analytical Framework 84

2.1 Outline of the Analysis 84
2.2 Normative Theory and Accounting Concepts 88

3 Evaluation Method 93

3.1 First Evaluation Level: Relevance 96
3.2 First Evaluation Level: Faithful Representation 101
3.3 Second Evaluation Level: Comparability 105
3.4 Second Evaluation Level: Verifiability 106
3.5 Second Evaluation Level: Timeliness 107
3.6 Second Evaluation Level: Understandability 108
3.7 Assessment of Second Evaluation Level 108

4 Analysis 110

4.1 First Level Analysis: Relevance 110

4.1.1 Full Capitalization 110
4.1.2 Full Expensing 112
4.1.3 Contra-Equity Accounting 113
4.1.4 Partial Capitalization 114

4.2 First Level Analysis: Faithful Representation 115

4.2.1 Full Capitalization 115
4.2.2 Full Expensing 116
4.2.3 Contra-Equity Accounting 117
4.2.4 Partial Capitalization 118
4.2.5 Summary of First Level Analysis 119

4.3 Second Level Analysis 122

5 Conclusions 125

The Conceptual Framework's (In-)Adequacy for Standard Setting

Abstract

Set against the background of the stalled convergence of R&D accounting, our article examines whether the FASB's and IASB's revised conceptual framework is suited to resolve the question of recognition of R&D expenditures. Based on a conditional-normative research approach, we first examine accounting theories to come up with a set of accounting methods for the treatment of R&D costs. Next, we assess these alternatives against the revised qualitative characteristics, which is an approach that the Boards assert to employ. We find that the conceptual framework is ill-suited to bring about a solution for R&D accounting. Our findings raise concerns on the adequacy of the conceptual framework for standard setting, which relate to inconsistencies in the framework and ill-defined qualitative characteristics. The framework seems to fall short of its pronounced purpose, which is to assist the Boards in solving standard setting issues. Our article reveals in which respects the framework would need to be revised and thus demonstrates how theory contributes to standard setting.

Keywords: conceptual framework, accounting theory, normative research, FASB, IASB, R&D accounting

1 Introduction

According to the Financial Accounting Standards Board's (FASB) Rules of Procedures and the International Accounting Standards Board's (IASB) Preface to IFRSs, the joint conceptual framework is the foundation on which accounting standards and financial reporting practice is supposed to rest. It is the 'deductive basis for the setting of accounting standards in accordance with a predetermined objective for financial reporting' (Loftus, 2003, p. 298) and is consulted when taking standard setting decisions (Barth, 2007a, p. 8). In 2010, the Boards finalized Phase A of their joint conceptual framework project which included the Objective of General Purpose Financial Reporting and Qualitative Characteristics of Useful Financial Information. In these documents, the Boards re-formulated and made explicit their basis for decision-making on standard setting issues.

Our article examines whether the joint conceptual framework suits its pronounced purpose by applying the framework's decision-making process to the controversial issue of accounting for research and development (R&D) expenditures. Based on a conditional-normative research approach, we introduce an analytical framework that combines accounting theory with evaluation criteria, which serve as the conditional element in our analysis. We first derive several accounting methods which accounting theories postulate regarding recognition of R&D. Next, we examine the Boards' conceptual frameworks to determine decision criteria that the standard setters use. Each previously derived accounting method is then assessed concerning the extent to which the method fulfills the pre-determined evaluation criteria. By applying the Boards' criteria for decision-making, we would come up with an accounting alternative for the treatment of R&D expenditures that is in line with both accounting theory and the Boards' prescribed characteristics of accounting information. Our analysis would also yield an accounting method best suited for converging US GAAP and IFRS with respect to the treatment of R&D.

However, we show that the Boards' conceptual framework is not suited to evaluate accounting alternatives. The proclaimed qualitative characteristics are not defined properly which makes their application highly interpretive. In addition, by not defining what the criteria actually mean the Boards make an evaluation nearly impossible. Accordingly, our analysis exposes in which ways the criteria are open for interpretation and we suggest that, if the Boards want their decision-making process to be considered objective, they need to reconsider the qualitative characteristics. Overall, we draw the conclusion that the qualitative characteristics are not suited for solving recognition questions, but present a tool to come up with transactions on which financial information should be disclosed, disregarding the way such a reporting should be designed. An alternative explanation could be that the Boards use the conceptual framework in their decision-making process, but have qualitative characteristics in mind that are more clearly defined and more precise than the ones published in the framework.

We consider the recognition of R&D expenditures suited well for this purpose for two reasons.[1] First, Sprouse (1988) writes of the time around issuing Statement of Financial Accounting Standard (SFAS) No. 2 in 1974 that 'the absence of meaningful concepts of assets and liabilities in the authoritative literature and lack of established criteria for accounting recognition were particularly frustrating in the

1 We explicitly leave out measurement aspects. While being aware that recognition and measurement are closely related, a comprehensive analysis of both aspects would be beyond the scope of our article.

research and development [...] project[s]' (p. 124). Likewise, Kirk (1988, p. 15) called the R&D project a catalyst for the FASB's Statement of Financial Accounting Concepts (SFAC) No. 3 on financial statement elements. Examining R&D expenditures also seems to be promising as Camfferman and Zeff (2009, p. 259) note that these costs might be in line with the framework's recognition criteria, although they are not capitalized. Second, R&D accounting is a controversial financial reporting issue that waits to be resolved for some time and remains one of the issues on which US GAAP and IFRS still differ. While the FASB's SFAS No. 2 requires an automatic expensing of all R&D costs, International Accounting Standard (IAS) 38 requires entities to capitalize development costs of an R&D project if certain criteria are fulfilled. What is more, efforts to converge the accounting rules have been halted since 2007.

Overall, our paper serves several purposes: First, by applying the Boards' decision-making process, we make inconsistencies in the conceptual framework apparent and demonstrate in what respect the Boards' proclaimed evaluation criteria are unsuitable. We are thus in line with Barth (2007a, p. 8) who asks for research that questions the conceptual framework and rethinks the qualitative characteristics of financial reporting. Second, it analyzes R&D accounting from a conditional-normative perspective using a theoretical, and thus rarely applied, approach. In light of the large number of empirical works on R&D accounting, this endeavor seems reasonable given the mixed results of accounting literature (e.g. Lev and Sougiannis, 1999; Kothari, Laguerre, and Leone, 2002).[2] Our analysis follows Bennett, Bradbury and Prangnell (2006) who argue that joint qualitative criteria

[2] For an overview of accounting research on intangibles see Cañibano, García-Ayuso, and Sánchez (2000). Wyatt (2008) provides a more recent overview of literature on the value-relevance of intangibles.

are needed to analyze and discuss a joint accounting standard on R&D. Third, it answers Dichev’s (2008) call for a renewed interest in normative research that provides clear recommendations for policy making and thus aims at improving financial reporting.

Our article proceeds as follows: In a first step, we build our analytical framework and derive four accounting methods for the treatment of R&D expenditures. Next, we use the standard setters’ conceptual frameworks to find criteria on which we conduct an evaluation of the accounting alternatives. Our subsequent analysis discusses each accounting method with respect to the evaluation criteria and reveals in what respects the Boards’ evaluation criteria are futile.

2 Analytical Framework

2.1 Outline of the Analysis

Our analysis makes use of the controversial issue of R&D accounting to examine whether the Boards' joint conceptual framework is suited to evaluate recognition concepts and propose a first best solution. In order to choose an accounting option for a specific issue, standard setters typically prefer ex ante research (Schipper, 1994, p. 62) that mainly relies on empirical research methodologies (Schipper, 1994, pp. 63-6; Barth, Beaver and Landsman, 2001). Nevertheless, concepts such as standard setters' conceptual frameworks are formed by normative analysis and can best be examined by using a normative approach. Similarly, Fülbier, Hitz and Sellhorn (2009, p. 468) point out that normative, policy-related research can be useful for standard setters. They refer to conditional-normative research (Mattessich, 1995, pp. 187-210), i.e. research grounded in theory that uses and explicates evaluative criteria based on the objectives and criteria sets of the standard setter at whom the research is directed. This research explicitly neither takes into consideration influences of political lobbyists (e.g. Zeff, 2002) nor analytical processes or compromises within the standard setting bodies (Miller and Bahnson, 2010). Hence, the outcome of our research can be seen as input to the political and pragmatic compromises standard setters are confronted with.

Accounting theories determine possible accounting options for an identified standard setting issue. These options have to be evaluated against a set of criteria that are pre-specified by the standard setter(s). Accordingly, we first identify accounting theories that suggest answers to the question of recognition of R&D expenditures. As we do not aim to provide an overview of accounting theories or a discussion of basic accounting concepts, we first have to derive a set of accounting theories that is useful for our purpose. Finding that accounting theories are categorized differently,[3] we cluster the theories that aim at postulating accounting norms into two main strands: On the one hand, there are the classical income measurement approaches which define how 'true income' is measured based on neoclassical economic theory[4] and propose how transactions are to be recognized. The works by Paton and Littleton (1940) and Sprouse and Moonitz (1962) fall into this category.

On the other hand, the decision-usefulness approaches, beginning with Staubus (1954) and Chambers (1955), describe what kind of information is useful to investors and how this information should be recognized and measured. Two main subcategories can be defined: value approaches and the events approach. Value approaches are mainly concerned with alternatives to measure assets. Several schools of thought can be identified that include a valuation at replacement cost (e.g. Edwards and Bell, 1961), at exit value (e.g. Chambers, 1966), and at net realizable value (e.g. Sterling, 1970). We summarize these approaches into one category as they are concerned with measuring assets and do not propose different concepts for the recognition of transactions. By contrast, the events approach, developed by Sorter (1969), criticizes the value approaches and promulgates a different accounting theory. The author suggests that users' needs are best satisfied if they receive disaggregated information on the major transactions that a

[3] American Accounting Association (AAA, 1977) and Whittington (1986) use research approaches as a distinguishing characteristic. Some approaches have been assigned to different categories by different researchers (e.g. Revsine, 1981, p. 343).

[4] According to AAA (1977), 'true income' theories assume that income should be measured using one valuation base. Such an income would meet the needs of all users and thus represent 'true income'.

company conducts during the year. Sorter (1969) does not suggest an appropriate degree of aggregation and, hence, does not prescribe how information on the transactions should be presented. However, he requires recognition of important transactions in general.

The qualitative criteria for evaluating accounting options have to be derived for both the IASB and the FASB. These criteria are given in the Boards' conceptual frameworks, which have a guiding function for both standard setting bodies. According to the FASB's Rules of Procedure (ch. II.C., p. 3), the SFACs are useful in 'providing a frame of reference, or conceptual framework, for resolving accounting issues'. In addition, the Rules of Procedure (ch. II.D., p. 4) prescribes that FASB members are to 'issue high-quality standards, which are grounded in a consistently applied conceptual framework.' A more precise definition of the FASB's Concepts is given in 'Scope and Implications of the Conceptual Framework Project', published on December 2, 1976: 'A conceptual framework is a *constitution*, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards [...]. The fundamentals are the underlying concepts of accounting, concepts that guide the selection of [...] the means of summarizing and communicating [events] to interested parties' (p. 2, emphasis in the original).

In the IFRS environment, the Preface to IFRSs (para. 8) postulates that 'IFRSs are based on the Conceptual Framework'. Thus, it is the 'objective of the Conceptual Framework […] to facilitate the consistent and logical formulation of IFRSs'. Finally, the Boards' joint framework sets out that it is to guide the Boards in 'developing accounting and reporting guidance by providing the Board[s] with a common foundation and basic reasoning on which to consider merits of alternatives' (preface to SFAC No. 8, p. 5). Hence, we follow the objectives and principles set out in the conceptual framework(s) and derive criteria that an accounting option would have to be evaluated against. By assessing each option based on these criteria, we reproduce the Boards' decision-making process to come up with an accounting alternative for R&D expenditures that is in line with both accounting theory and the standard setters' criteria for high-quality accounting standards. Our analysis allows us to test whether the qualitative criteria suit their purpose of being the evaluating frame for accounting concepts and, possibly, reveals inconsistencies or shortcomings of the qualitative characteristics.

Despite their fundamental importance for standard setters, conceptual frameworks have been criticized as unsuitable for conditional-normative analyses. Especially the FASB's conceptual framework has drawn a lot of criticism over the years. Several authors (e.g. Miller, 1985; Christensen, 2010, pp. 297-8) have argued that the conceptual framework is incoherent and too detailed. In addition, they doubt that a framework is suited to provide financial reporting with an appropriate theoretical foundation and can hardly be considered suitable for assessing accounting alternatives. Similarly, Christensen and Demski (2007) show that the framework's focus on qualitative characteristics of financial information prevents accounting standards from being based on economic fundamentals. Regardless of this critique, standard setters have used and will continue to use conceptual frameworks when developing accounting standards (Gallery and Gallery, 2004; Whittington, 2008). Our article thus needs to be seen in the context of studies that test whether accounting standards are consistent with the conceptual framework(s) (e.g. Mozes, 1998; Loftus, 2003; Wüstemann and Kierzek, 2005) rather than articles that assess the general suitability of a conceptual framework.

In 2004, the FASB and the IASB began developing a joint conceptual framework as a basis for future joint work. The Boards approached the project by splitting it into eight phases that were initially planned to be completed by 2010. However, they have halted the project as it was considered low priority in the context of the financial crisis.[5] By now, the objective and qualitative characteristics (Phase A) have been finished and published. Elements and recognition as well as measurement (Phase B and C) have merely been discussed, whereas the Boards have published an exposure draft on the reporting entity concept (Phase D). The other phases (Phase E through H) have not yet been approached.

We will make use of the joint conceptual framework as far as possible. Nonetheless, we need to conduct parts of our analysis based on the Boards' individual conceptual frameworks. In particular, we take the definition and recognition criteria of financial statement elements from the FASB's SFACs No. 5 and No. 6 and the IASB's 1989 version of the Framework for the Preparation and Presentation of Financial Statements, respectively. Other sections of the conceptual frameworks are not relevant for our analysis.

2.2 Normative Theory and Accounting Concepts

We proceed by examining the accounting theories regarding their views on the recognition of R&D expenditures. Following a brief introduction of each theory,

[5] By now, the IASB has re-begun its work on the framework, continuing the project without the FASB.

we analyze which recognition option they explicitly or implicitly suggest for R&D. By doing so, we ensure that the accounting alternatives examined in later chapters are grounded in theory.

Starting with the income measurement approaches, we begin with the work by Paton and Littleton (1940), also known as the revenue-and-expense view. This theory hinges on the principle that expenses are assigned to revenues, i.e. expenses or costs are recorded in the income statement once the revenue associated with the product or service that caused the costs is recognized. In turn, costs are recorded as assets if revenue streams are expected in future periods. Thus, assets are 'revenue charges in suspense' that await 'some future matching with revenue as costs or expenses' (Paton and Littleton, 1940, p. 25).

It follows that R&D expenditures also need to be matched with revenues that result from R&D projects. Hence, all R&D costs would be recorded on the balance sheet and transferred to the income statement once the corresponding R&D project yields a product that generates revenue. However, an R&D asset would have to be transferred to the income statement earlier if a project will eventually not result in a revenue-generating product. Based on this reasoning, Paton and Littleton (1940, pp. 91-2) argue that it may be advisable to not fully match the costs for R&D. That would be the case if circumstances suggest that a procedure other than full matching is more appropriate or if it is not feasible to properly match expenses with revenue. As a result, anything between full matching, i.e. capitalization of all costs, and immediate expensing of R&D costs can be recommended. Circumstances suggest how the entity accounts for their R&D expenditures.

The second income measurement approach is the theory formulated by Sprouse and Moonitz (1962), later known as the asset-and-liability view. The authors (p. 5) argue that Paton and Littleton's (1940) strong focus on the income statement does not produce satisfactory results. They aim to shift emphasis to the balance sheet and, accordingly, define its elements, postulating that all elements that are assets, liabilities or equity should be carried on the balance sheet. Hence, we would need to analyze whether R&D expenditures fulfill one of the authors' definitions. However, Sprouse and Moonitz (1962, p. 22) conduct this analysis themselves and describe that 'research and development costs also fall within the class of assets […] because they create or embody future economic benefits.' They continue to describe R&D costs as 'assets in their "purest" form because their value depends directly on "future economic benefits"' (p. 36). Thus, according to Sprouse and Moonitz (1962), R&D expenditures are assets and should be carried on the balance sheet.[6]

Sprouse and Moonitz (1962, p. 36) acknowledge that it may be difficult to value R&D assets because current or future exchange prices are unobservable. As a result of these measurement problems, an alternative accounting concept can be offered. Johnson (1976) suggests using contra-equity accounting for R&D projects. According to this approach, R&D projects would be charged directly to a contra-equity account, i.e. as a reduction of equity, to report the usage of resources in the course of the project. Subsequently, when knowing that a certain project is successful, the entity would transfer the contra-equity R&D project to the asset

6 SFAS No. 2 is often considered a standard that shows the FASB's commitment to the asset-and-liability view (e.g. Zeff, 2005). One could argue that capitalizing R&D expenditures would not be in line with this theory. However, our analysis bases solely on Sprouse and Moonitz (1962), who explicitly discuss the treatment of R&D expenditures.

side of the balance sheet. Alternatively, if the project was not successful, the contra-equity account would be transferred to retained earnings.[7] By using this approach, an entity would report the R&D project as an asset 'on hold' as long as its future economic benefits are uncertain, doing so in a contra-equity account. Sprouse (1966) could be interpreted as criticizing such an approach because of a possible violation of the accounting equation. Nonetheless, contra-equity accounting for R&D does not violate the equation because equity may well be a negative number. When conducting R&D, both assets and equity are reduced, balancing out the equation. Hence, two accounting alternatives are derived from the asset-and-liability view: full capitalization of R&D expenditures and contra-equity accounting.

Next, we turn to the decision-usefulness approaches that postulate which information is useful for investors and should be reported. We note that, to the best of our knowledge, these theories do not clearly suggest which items should be carried on the balance sheet or recorded in the income statement. Instead, they emphasize measurement aspects, prescribing that assets should be measured, e.g., at replacement cost (Edwards and Bell, 1961), exit value (Chambers, 1966) or net realizable value (Sterling, 1970). We conclude that the theories defer the issue of recognizing R&D expenditures to the measurement stage, i.e. each project will be recognized individually when it is acquired and measured at a certain value. The value of an R&D project can still be zero, implying that all costs are charged to the income statement, either directly or by immediately writing off the asset.

[7] Carrying this idea forward to today's financial reporting environment, such a method would involve 'other comprehensive income' in one way or another.

Finally, we examine the events approach based on Sorter (1969) who prescribes that the purpose of accounting is providing information about events relevant for decision-making. Accordingly, financial statements should report the main events of the period and from the time of the entity's founding. The reporting should be done in a disaggregated form. Following the events approach, we conclude that R&D projects are relevant events for a company as they may be seen as an indicator of entities' future competitiveness (e.g. Lev and Sougiannis, 1996) and that a company would need to report them in its financial statements. However, part of the criticism the events approach drew is that it does not prescribe how and in which form events should be reported (Johnson, 1970). Thus, the events approach does not seem to favor one of the accounting alternatives, but permits all of the previously derived methods as they all imply that R&D projects are reported in the financial statements: full capitalization, full expensing, contra-equity accounting, and partial capitalization.

3 Evaluation Method

The application guidance for the qualitative characteristics is a new feature of the joint conceptual framework. Previously, the frameworks only included a list of qualitative characteristics without explaining how these are applied. The Boards thus now disclose an evaluation process using the qualitative characteristics or, given their claim to use the framework in standard setting, their normative decision-making process. The application guidance helps us identify a deductive decision model that is open to a normative assessment regarding its suitability to recommend an accounting solution.

After having identified an economic phenomenon that may be useful to users of financial statements, it needs to be evaluated whether financial information about that phenomenon fulfills the fundamental qualitative characteristics of 'relevance' and 'faithful representation' (QC18). If both characteristics are fulfilled, the financial information is decision useful (QC18). If not, the assessment 'is repeated with the next most relevant type of information' (QC18). These requirements yield a first level for an analytical framework on which relevance and faithful representation of accounting alternatives are assessed. The method that leads to highest relevance and ensures faithful representation is preferred.

However, we need to question how the two characteristics are linked. Although the word 'and' (QC4) suggest an additive link, we do not find more information on this. Based on QC18's decision rule, we could also argue that the most relevant solution should be chosen given it is faithfully represented. In that case, faithful representation would only be a constraint that, if not fulfilled, hinders the most relevant alternative from being chosen. Similarly, it remains unclear whether relevance and, in particular, faithful representation are scaled or binary characteristics.[8] Arguably, relevance is scaled since one accounting alternative can be more relevant to users than another and the most relevant alternative should be assessed first. Faithful representation seems to be either fulfilled or not (QC18). However, the framework indicates that there can also be lower degrees of faithful representation (QC12). In addition, having three sub-criteria, i.e. completeness, neutrality and freedom from error, suggests that faithful representation can be partially fulfilled. That is, unless partial or non-fulfillment of one of the sub-criteria signifies lack of faithful representation. For the sub-criteria, it is also not specified whether they are linked additively, multiplicatively or whether there is an emphasis on one (or two) of the criteria.

According to the framework, further analysis of accounting methods employs the enhancing qualitative characteristics of comparability, verifiability, timeliness and understandability, which are considered only if relevance and faithful representation of two or more accounting concepts is fulfilled to a similar extent (QC19).[9] Again, it is questioned how the characteristics interact and whether they can be fulfilled in part. It is also unclear which kind of analysis the guidance on the enhancing characteristics requires. QC33 requires that 'enhancing qualitative characteristics should be maximized to the extent possible'. Thus, the accounting concept which leads to the highest performance on all four enhancing qualitative cha-

8 The same question can be asked for decision usefulness itself since fundamental qualitative characteristics make information useful, i.e. it is useful, but enhancing qualitative characteristics can increase usefulness.

9 The application guidance for the fundamental qualitative characteristics suggests that the first level assessment is 'subject to the effects of enhancing characteristics and the cost constraint'. This statement is inconsistent with the remaining guidance, which argues that, in a first step, only the fundamental qualitative characteristics matter.

racteristics is preferred. On the other hand, QC34 suggests that 'one enhancing qualitative characteristic may have to be diminished to maximize another'. As a result, an individual judgment would be required that assesses the relative importance of one enhancing qualitative characteristic over another with the overall goal to maximize all enhancing characteristics jointly. Is an analysis objective if it entails an estimating the effects of the individual enhancing criteria on relevance and faithful representation? In fact, the evaluation process may turn out to rely solely on individual judgment. Adding to this is the vague description that the application 'is an iterative process that does not follow a prescribed order' (QC34). Given a normative understanding of an evaluation process, a decision-making tool should be based on an objectified assessment that leaves out subjective components. As a result, the framework's application guidance lacks definitional clarity.

In addition, for all qualitative characteristics, we need to question to what they actually pertain. Are they needed for the recognition of a transaction, for measuring an element, or are they equally important for both stages? Vice versa, we question whether the characteristics can be applied at all to recognition and measurement separately or whether accounting solutions need to be considered in their entirety. How is uncertainty considered in the standard setting decision? What role do disclosures play? An evaluative frame would require that there is a clear definition of the scope of application. Otherwise, the characteristics as well as the evaluation process leave room for interpretation and do not represent an objective decision-making process.

The final step in the evaluation introduces a cost constraint on useful financial reporting (QC34-39). This constraint comes into effect only once accounting alternatives have been evaluated and is assessed by seeking information from different sources such as providers of financial information. It has no effect on the actual evaluation or ranking of accounting concepts based on the framework's criteria. It may only hinder the first-best accounting concept from being implemented, if this concept imposes on preparers costs that are not justified by corresponding benefits.

Again, the cost constraint's inherent subjectivity, which the framework itself mentions (QC39), needs to be criticized. Since the description of costs and benefits is very vague, it is nearly impossible to reproduce such an assessment or to conduct an objective cost-benefit-analysis of a proposed accounting alternative. The Boards had been aware of this issue (Barth, 2007a, p. 9) but did not change the cost constraint in their joint framework. We may well speculate whether this is due to the mere impossibility of an objective assessment of costs and benefits or whether the Boards embrace the constraint as a final means of preventing unwelcome accounting concepts from coming into effect. Due to the inherently subjective nature of a cost-benefit analysis and the lack of information on how to conduct such an assessment, we refrain from analyzing the accounting methods regarding costs and benefits and focus our following analysis on the qualitative characteristics.

3.1 First Evaluation Level: Relevance

Financial information is relevant if the information 'is capable of making a difference in the decisions made by users' (QC6), regardless of whether users take advantage of this information and actually act differently. Information can make a difference in users' actions if it has predictive or confirmatory value or both (QC7).

Such a description leaves plenty of room for interpretation because there is no additional explanation included on what the definition actually entails. Hence, the framework's definition of 'relevant information' seems impracticable to work with for standard setters and preparers: What information has predictive or confirmatory value and should be reported in financial statements? The definition implies that relevance can only be measured by examining users' knowledge growth from receiving financial information. Given this understanding, the characteristic is not operational for a normative analysis but might require empirical examination, rendering an ex-ante assessment difficult.

Nevertheless, by defining elements of financial statements like assets, liabilities and equity and pointing out their importance for financial reporting by describing that these elements represent economic resources and claims, the Boards come up with an implicit assertion: Everything that is an asset, liability, equity, revenue or expense is relevant; otherwise these elements would not be reported. The FASB's now superseded SFAC No. 2 yields support for this assessment since it describes that 'information about the present status of economic resources or obligations or about an enterprise's past performance is commonly a basis for expectations' (SFAC No. 2.48) and thus for information to be relevant. Hence, our analysis of relevance entails an assessment of whether element definitions and, if applicable, recognition criteria provided in the framework are fulfilled by the accounting alternatives under review.[10]

Since we examine full capitalizing, full expensing, contra-equity accounting, and partial capitalization, we need to find definitions for these elements. Given that the revised framework has not yet proceeded to financial statement elements, we need to include the Boards' individual frameworks at this stage and, if necessary, combine the definitions.

Full capitalization implies recognition of all R&D expenditures as assets and we need to define what a recognizable asset constitutes. According to the IASB's Framework, an asset is 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity' (F4.4(a)). It can be recognized if '(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability' (F4.38). The FASB uses a similar definition, describing an asset as 'probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events' (SFAC No. 6.25). Under US GAAP, an asset can be recognized if the item meets the element definition, is measurable with sufficient reliability, is capable of making a difference in user decisions (relevance), and is representationally faithful, verifiable, and neutral (reliability) (SFAC No. 5.63). The latter terms of relevance and reliability are taken from the qualitative characteristics and assumed to be

[10] Our reasoning is at least partly backed by Barth (2007a, p. 8): 'the definitions identify what should be measured'. That is, they identify what should be on a balance sheet. However, Barth (2007b, p. 57) points out the following question for future research: 'Should all assets and liabilities be recognized, or should there be additional criteria imposed?'

given if the asset definition is fulfilled. Consequently, we exclude these two criteria and find the following criteria to be used by either of the two Boards: 'controlled resource', 'past event', 'probability of future economic benefits', 'reliable measurement'. Our analysis only covers the recognition of R&D costs which is why we consider the criterion of 'reliable measurement' to be fulfilled or at least achievable by the preparer, e.g. by implementing an adequate costing system.

According to full expensing, all R&D costs are expensed as they are incurred. For the IASB, expenses entail both expenses in a narrower sense, which exclusively arise in the course of an entity's ordinary business activities, and losses, which may or may not occur in the course of ordinary business. Losses are not regarded as a separate element in the conceptual framework (F4.34), which is why we do not consider them necessary for our purpose. Expenses are defined as 'an outflow or depletion of assets' (F4.33). The FASB separates expenses and losses and defines expenses as 'outflows or other using up of assets or incurrences of liabilities (or a combination of both)' (SFAC No. 6.80). Consequently, our definition of expenses entails the following two characteristics: 'outflow or usage of assets' and 'incurrence of liabilities'.

Contra-equity accounting requires a company to defer the recognition decision by debiting the equity account 'contra-equity – R&D project'. Both Boards define equity as a residual, namely 'the residual interest in the assets of the entity after deducting all its liabilities' (F4.4(c)) and as 'net assets, the difference between the enterprise's assets and its liabilities' (SFAC No. 6.60), respectively. A joint definition would thus encompass: 'assets less liabilities'.[11] While we define assets above, we refrain from pursuing a definition of liabilities because R&D activities typically do not influence an entity's liabilities directly and this part of the accounting equation remains constant or is only marginally influenced.[12]

We further need to consider whether there is a certain emphasis among financial statement elements. That is, if there is a transaction that fulfills the definition of more than one element, we need to know which element should be preferred. A first approach to this issue would be to consider the Boards' assertion to take an asset-and-liability view to financial reporting, which implies that the balance sheet is more important than the income statement. If a transaction fulfills both asset and expense definitions, the financial information would need to be reported as an asset. Similarly, if the Boards were to follow a revenue-and-expense view, the solution to the problem would be vice versa. These considerations hinge on the assumption that the Boards indeed take a consistent theoretical view to financial reporting. While Zeff (2005, p. 20) confirms that the FASB generally follows an asset-and-liability view, Wüstemann and Kierzek (2005, pp. 75-6) show that the Boards take a mixed approach to financial reporting. According to Storey and Storey (1998, p. 79), the normative frame of the conceptual framework gives conceptual primacy to assets and liabilities. Does this normatively stated preference for the asset-and-liability view mean that assets are more relevant than expenses? Not necessarily. Gellein (1986, p. 15) argues that '[c]onceptual primacy has noth-

[11] Contra-equity accounting may require a treatment based on other comprehensive income. Since the framework does not include a definition of this element, we cannot conduct such an analysis.

[12] Partial capitalization alternates between expensing and capitalizing R&D costs and thus concerns only elements that are already defined.

ing to do with the question of what information is most useful or of how it is measured. It refers only to the matter of definitional dependency.' As a result, it remains unclear whether taking an asset-and-liability view means that balance sheet elements are more relevant than income statement elements.

It might even be argued that the framework's preference for accrual accounting (OB17) expresses an emphasis of a matching approach to financial reporting. As a result, taking a revenue-and-expense view would imply a preference for income statement elements. Given that there is no statement on the hierarchy of elements or consistency of the underlying theoretical view on financial reporting, we conclude that under the current framework an unambiguous assessment of what is more relevant needs to rely on additional assumptions. Alternatively, there may also be no hierarchy among the elements because 'income statements and balance sheets work together to indicate firm value, and each statement can correct for the deficiencies in the other' (Penman, 2009, p. 359).

3.2 First Evaluation Level: Faithful Representation

An economic phenomenon is faithfully represented if it suffices the three characteristics of completeness, neutrality and freedom from error (QC12). Obstacles to assessing faithful representation foremost relate to the concept of an economic phenomenon, which is not defined. While the Objective of Financial Reporting uses the term 'economic resources and claims' to describe financial statement elements, it is only in the introduction to the Qualitative Characteristics that these terms are mentioned. Instead, that chapter discusses, but does not define, 'economic phenomena', in particular in the context of faithful representation (QC12). While it is apparent that a resource or claim is different from a phenomenon, the

Boards seem to assign similar meanings to the expressions (QC2). Based on common sense, we suppose that an economic phenomenon is something like a transaction or an event that arise in the course of business. Still, it is not clear how to distinguish between phenomena that should be accounted for and those that should not be reported in financial statements. Also, it is not specified what such a phenomenon comprises, whether it is only one action in an enterprise or a combination of those. In the case of R&D, we would need to determine whether an economic phenomenon comprises a company's entire R&D program, one particular R&D project or one action in an R&D project, such as an experiment. This discussion raises the issue of the portfolio level on which R&D projects can be evaluated and which reduces uncertainty of the outcome (Bierman and Dukes, 1975, p. 50).

Similarly, it can be questioned what an economic phenomenon constitutes when discussing interactive activities such as R&D. Certain activities or transactions may not be unanimously classified as research or development, at least not from a practical point of view. That is, is research *or* development the phenomenon or is research *and* development the economic phenomenon whose faithful representation should be assessed?

Without resolving this issue, we assume that R&D is an economic phenomenon in the sense of the framework that should be reported. In addition, we need to assume that the reporting entity is aware of its R&D projects and, consequently, possesses or is able to generate financial information needed to recognize these projects.

The framework goes on to define completeness as being fulfilled if all information necessary for a user to understand the underlying phenomenon is depicted in the financial statements (QC13). Completeness entails both numerical as well as verbal descriptions of the phenomenon such that explaining a transaction in words helps achieve completeness and contributes to faithful representation. In turn, this effect implies that no matter which recognition alternative is chosen, a verbal description in the notes can heal lack of completeness. It can be doubted whether completeness is a suitable tool to distinguish between recognition alternatives. These concerns can be rephrased: Which accounting concept is 'more complete' if disclosure reduces lack of completeness? This conclusion weighs more gravely if we consider that it is not clear in what respect completeness should be achieved. Which underlying economic characteristics should be reported to achieve completeness? If the characteristic relates only to cash flows, capitalizing all R&D expenditures depicts all cash flows just as complete as a full expensing of the costs. If, by contrast, we assume that completeness also entails the likelihood of success of an R&D project, neither full capitalization nor full expensing fulfills the criterion. For the purpose of standard setting, completeness seems ill-defined and does not represent a criterion to choose between alternatives. As a result, we exclude the characteristic from our analysis.

Neutrality of financial information is given if a depiction is without bias, i.e. if the information given is 'not slanted, weighted, emphasized, de-emphasized or otherwise manipulated' (QC14). By including neutrality, the Boards decided against conservatism (BC3.27-3.29). This decision brings about a substantial change from the traditional way of accounting which is based on conservatism (e.g. AAA FASC, 2011, p. 579). However, the Boards do not explicate whether neutrality pertains to recognition or measurement or both. Christensen and Demski (2007) implicitly assume that neutrality mainly refers to the measurement of financial statement elements. In that sense, the term 'bias' seems key to understanding neutrality, although it is not specified in what regard financial information should not be biased. That is, should the financial position not be biased? Should the economic phenomenon not be presented in a biased way? When the FASB's SFAC No. 2 defined bias in its glossary of terms, it spoke of 'bias in measurement' and 'bias in accounting measures', but not of recognition. Considering the further framework text on neutrality, it seems indeed that neutrality addresses mainly measurement aspects of financial statement elements and seems to be directed largely at preparers. Nonetheless, we suggest that it also alludes to the recognition of transactions because a weighting or emphasis of certain information may be achieved by choosing among recognition options. A neutral depiction then is best achieved if companies are not given the opportunity to emphasize or deemphasize information and an accounting alternative not granting discretion to preparers with respect to recognition would be preferred.

As a final step to achieving faithful representation, the framework requires information to be free from error, which relates mainly to the process of generating the reported information and the application of a model. While not meaning accurate in all respects, the characteristic implies that estimates should be determined using an appropriate process. The criterion, due to its frequent reference to prices, values and estimates, suggests that it addresses mainly how an element is measured. In addition, the Boards state that preparers can describe an amount as being an estimate to fulfill the criterion, which again indicates that verbal disclosure can heal an error. However, to some extent, freedom from error also affects recognition of a transaction since it requires that 'no errors or omissions in the description of the phenomenon' (QC15) are made. If 'description' is understood as depiction in financial statements, the criterion requires the presented information to correspond to the underlying economic characteristics of the phenomenon, avoiding erroneous reporting or lack of information. Freedom from error may even require that all economic characteristics of a transaction are presented correctly, i.e. it could be a completeness requirement for reporting underlying economic characteristics. Still, the question of precisely what an error constitutes remains unanswered. Is it a misrepresentation of the underlying transaction or a mistake made in the application of a measurement method? Does the framework's understanding of an error correspond to the one of IAS 8 and SFAS No. 154, respectively? If we understand an error as a mistake, we might conclude that, from a recognition perspective, neutrality covers an intentional bias, whereas freedom from error aims to avoid an unintentional bias.

3.3 Second Evaluation Level: Comparability

Comparability of financial information is achieved if users are able to judge financial information against similar one from another entity (inter-entity comparability) and against similar one from the same entity over time (inter-period comparability) (QC20). The framework further states that 'some degree of comparability is likely to be attained by satisfying the fundamental qualitative characteristics' (QC24). An accounting method presenting relevant information in a faithful way is most likely comparable. However, if a method allows different accounting for the same economic phenomenon giving preparers discretion, its comparability is reduced although the method may satisfy the two fundamental characteristics (QC25). This example suggests that allowing preparers to choose among options reduces comparability. The Boards seem to assume that taking discretion from preparers maximizes comparability in both dimensions.

Accounting literature questions whether the criterion is suited for solving accounting issues. Dyckman (1988, p. 11) states that comparability is 'a concept not easily applied even if easily defined'. Young and Williams (2010) and Durocher and Gendron (2011) indicate that comparability requires a value judgment due to an assessment of the (dis-)similarity of transactions, which significantly questions the practicability of the entire concept. Despite these concerns, we postulate – based on the Boards' assumption derived above – that an accounting method providing fewer accounting options and giving preparers less discretion improves the comparability of financial information.

3.4 Second Evaluation Level: Verifiability

Faithful representation is enhanced if financial information is verifiable. This characteristic entails the requirement that different independent observers arrive at a similar estimate for an event (QC26). The Boards seemingly assert that there is a third party – leaving open whether this is just one person or a 'jury' – that can reproduce and confirm that a company's accounting for a transaction is a faithful representation. That third party would need to cross-check whether completeness, neutrality and freedom from error are fulfilled. The external party would need access to data and internal information as well as have knowledge about both the transaction and the company to arrive at a conclusion.

Verifiability does not seem to be helping standard setters since it merely requires re-examining faithful representation. It is to assure that there is no bias in the information and that there are no errors in the process of generating information, but it does not concern the evaluation of accounting alternatives from a standard setter's point of view. In addition, the framework states that verifiability can be enhanced by disclosure (QC28), which also helps achieve completeness, another sub-criterion of faithful representation. As a result, it remains unclear which additional aspect verifiability covers that is not part of faithful representation. We do not see a distinction between the two characteristics and suggest that verifiability is to ensure credibility of accounting information. In that case, the criterion would require appropriate disclosure to support faithful representation or be included for practical purposes, i.e. for helping preparers apply accounting rules and helping users evaluate accounting information. However, since verifiability does not add to evaluating accounting alternatives, we exclude the characteristic from further analysis.

3.5 Second Evaluation Level: Timeliness

Timeliness requires that users receive information in time such that they may be able to change their decisions based on this information (QC29). It purports that a transaction should be reported as soon as the preparer observes the transaction. However, once established that an economic phenomenon should be recorded in the financial statements, it is debatable whether timeliness is suitable for choosing among accounting alternatives. The company observes a transaction and subsequently records it according to the respective accounting method. Thus, timeliness is entity-specific and not a standard setting concept (Bradbury and Harrison, 2012) and we exclude it from our analysis.

3.6 Second Evaluation Level: Understandability

Understandability requires an entity to classify, characterize and present information in a clear and concise manner (QC30). The Boards acknowledge that some economic phenomena are complex and cannot be depicted in a way that is understood easily. To not exclude this information, the Boards make clear that financial statements are prepared for users with reasonable knowledge of business and economics and that 'even well-informed and diligent users may need to seek the aid of an adviser' (QC32). Accordingly, complexity of an accounting method cannot hinder it from being desirable, given the other criteria are maximized. Simultaneously, complex transactions are to be presented 'clearly and concisely' (QC30, BC3.42). We cannot determine how this self-contradictory statement is solved. Given the predominant position of the core text over the Basis for Conclusions, the irrelevance of complexity tends to prevail and we exclude it from our further analysis.

3.7 Assessment of Second Evaluation Level

We find that not all enhancing qualitative characteristics help select an accounting method. More precisely, verifiability, timeliness and understandability are irrelevant for or cannot be applied to standard setting questions. Only comparability, which requires a value judgment, seems to contribute to standard setters' debates. However, this enhancing characteristic is ill-defined in that it remains unclear exactly what should be comparable. As a result of our discussion, the Boards' second level analysis collapses to an evaluation of comparability. Table 1 summarizes the criteria on which we base our analysis.

First evaluation level: Fundamental qualitative characteristics	
Relevance (QC6-10)	
Recognizable Asset (F4.4 / 4.38 and SFAC No. 6.25 / 5.63)	- Controlled resource - Past event - Probable future economic benefit
Expense (F4.35 and SFAC No. 6.80)	- Outflow or usage of assets - Increase in liabilities
Equity (F4.4 / 4.38 and SFAC No. 6.60)	- Assets less liabilities
Faithful representation (QC12-16)	
Completeness (QC13) Neutrality (QC14) Free from error (QC15)	
Second evaluation level: Enhancing qualitative characteristics	
Comparability (QC20-25)	

Table 1: Overview of Evaluation Criteria Used in the Analysis

4 Analysis

Since our earlier discussion questions whether the framework is suitable to decide between recognition alternatives for R&D accounting, we describe in the following in what respect and to which extent we base our analysis on assumptions. We also discuss how interpretations dominate the final selection of a recognition alternative. Nonetheless, we will be able to come up with a ranking of the accounting alternatives, which due to our assumptions and interpretations may be a subjective outcome. At the same time, our analysis reveals how interpretation of the framework's characteristics influences the decision-making process and may thus serve as a recommendation to re-examine the criteria.

4.1 First Level Analysis: Relevance

4.1.1 Full Capitalization

Full capitalization advocates recognizing all R&D expenditures on the balance sheet. Thus, we need to assess whether there is a resource that is controlled by the entity, results from a past event, and yields probable economic benefits.

While legal rights to a resource are sufficient to fulfill the control criterion, they are not essential to control a resource. Instead, an entity needs to be able to obtain the benefits from the resource and control others' access to it to exercise control. New knowledge generated by R&D and kept within an entity is proprietary and therefore not accessible by others. The company is the only one that can obtain the benefits flowing from the resource and can be assumed to exercise control over internal R&D projects.

Concerning the past event, Johnson (1994, pp. 7-8) observes that recognition decisions often differ, although the same definitions of assets and liabilities are used. He argues that there are two important events, the original transaction and its realization, in our case conducting R&D being the first and obtaining economic benefits being the second. The one-event view proposes that the transaction should give rise to recognition as long as there is sufficient probability for the second event. The latter group, however, considers the occurrence of the second event, i.e. realization, as the basis for making recognition decisions. While the Boards are silent on how they define an event, we conclude that the one-event view dominates because the framework specifies that economic benefits, i.e. the second event, need to be *probable* to recognize an asset. Full capitalization requires an entity to capitalize all R&D costs that were incurred in one period. Thus, only past expenditures are capitalized, i.e., the asset created by this accounting alternative would be a result of past events.

Next, we assess whether R&D activities produce probable future economic benefits. In SFAS No. 2, the FASB acknowledged that an entity conducts R&D activities to obtain future economic benefits. Otherwise, companies would not engage in them (par. 51). However, the Board doubted that individual research programs' benefits are probable enough to justify capitalization of the associated costs. If probability is defined as 'virtually certain', full capitalization is certainly inappropriate since it treats all R&D expenditures alike and does not consider that some projects may not result in future economic benefits. Referring to this issue, Bierman and Dukes (1975, p. 50) indicate that an entity can considerably reduce its uncertainty regarding the profitability of R&D by observing the probability of future economic benefits on a portfolio level. Doing so, entities can be reasonably sure that benefits will flow to the company. In its criticism of this reasoning, the FASB expressed doubts mainly concerning measurement aspects, leaving out recognition considerations.

In the framework, the Boards argue that companies are to consider uncertainty in the context of measurement and valuation, not recognition. As an example, the IASB refers to receivables, which are recognized in spite of the uncertainty regarding whether or not cash is collected (F4.40). Instead of altering recognition, companies account for the remaining risk by including an allowance for uncollectible accounts. Given that R&D projects yield future economic benefits with a given probability, capitalization of the corresponding expenditures might be appropriate, if uncertainty was considered in the measurement stage. This example indicates that distinguishing between recognition and measurement of an asset is not entirely possible.

Overall, it remains unclear (1) how 'probability' is defined, (2) whether R&D projects should be evaluated on a project or portfolio level, and (3) whether uncertainty should be taken into consideration in the recognition or in the measurement phase. As a result, we cannot unambiguously determine whether full capitalization is in line with the requirement of probable future economic benefits.

4.1.2 Full Expensing

Regarding full expensing, we need to analyze whether R&D expenditures are outflows or usage of assets or whether the entity incurs liabilities in the course of R&D projects. The first part of the definition is always fulfilled because R&D

activities require an entity to use up some of its assets. For example, this usage may be a result of it paying researchers' salaries or acquiring raw materials and supplies that are used in R&D activities. In addition, if an entity, for example, contaminates land while conducting R&D, it also incurs a liability. We conclude that full expensing is in line with the definition of expenses and is therefore a relevant alternative.

4.1.3 Contra-Equity Accounting

Contra-equity accounting requires that two element definitions need to be analyzed, namely the one of a recognizable asset and the one of equity. Concerning the definition of a recognizable asset, we refer to our discussion of full capitalization. At least some R&D expenditures fulfill the definition of a recognizable asset, while other R&D projects will not yield economic benefits. The most severe weakness we identified is the inadequate definition of probability and the treatment of uncertainty. In the case of contra-equity accounting, however, both issues are of lower importance because R&D expenditures are recognized as assets only if an entity is certain that it receives economic benefits. Contra-equity accounting thus employs Johnson's (1994, pp. 7-8) second event, i.e. obtaining economic benefits. As a result, assessing the probability of economic benefits would be avoided.

Prior to being able to determine a project's success, an entity records R&D costs in a contra-equity account. R&D activities always coincide with outflows or a using up of assets, which, ceteris paribus, reduces the total asset balance without changing the liabilities of a company and equity is reduced. This relationship is correctly represented by a debit to a contra-equity R&D project account and a credit to an asset account. We would arrive at a similar conclusion if we used the frameworks' definition of equity as the ownership interest in an entity (SFAC No. 6.60). By using up assets in the course of an R&D project, ceteris paribus, the ownership interest is reduced. Taking into account that both the definition of a recognizable asset and the one of equity are fulfilled, we conclude that the financial information produced by contra-equity accounting is relevant.

4.1.4 Partial Capitalization

While we established earlier that R&D costs are expenses in the sense of the framework, a discussion of R&D expenditures that are recorded as assets is warranted. Referring to the discussion held on full capitalization, we argue that this alternative aims at reducing the uncertainty inherent in R&D projects by allowing an expensing of certain costs. More specifically, the alternative wants to avoid capitalizing expenditures that do not yield future economic benefits. Nevertheless, some uncertainty remains as an entity needs to assess subjectively which costs are expensed and which are capitalized. In other words, the alternative requires an entity to assess the point in time at which Johnson's (1994, pp. 7-8) second event is sufficiently probable to recognize subsequent expenditures as assets. Since the alternative requires an ex ante decision on the outcome of R&D projects, the method misstates information in the case of expenditures initially recorded as expenses although the corresponding project turns out to be successful. In hindsight, these expenditures would have had to be recorded as assets, and vice versa.

Overall, partial capitalization seems to produce more relevant information than full capitalization because it allows flexibility in the treatment of R&D expenditures and, to an extent, reduces the entity's uncertainty of assessing the probability of future economic benefits. Nevertheless, this flexibility relates to subjective assessments that may easily turn out to be wrong, implying that some uncertainty remains in the depiction of R&D. As this problem does not arise for the other alternatives, partial capitalization ranks below full expensing and contra-equity accounting.

4.2 First Level Analysis: Faithful Representation

4.2.1 Full Capitalization

To analyze faithful representation, we begin by assessing neutrality, which, according to our interpretation, is applicable to recognition aspects in one particular dimension. That is, an accounting alternative not granting discretion to preparers is preferable to one that does. According to full capitalization, all R&D expenditures are recorded in one way, i.e. all R&D costs are capitalized. Preparers do not have an opportunity to bias information and full capitalization produces neutral financial information.

Freedom from error, which mainly relates to the measurement of financial statement elements, pertains to recognition questions in that it requires the description of the phenomenon to be related to the underlying transaction. In our assessment of the relevance of the information produced by full capitalization, we concluded that depicting all R&D expenditures as assets at least partially misstates the underlying transaction since it includes unsuccessful R&D projects. Expenditures relating to these projects would have to be recorded as expenses because they do not produce future economic benefits. Consequently, R&D assets resulting from full capitalization contain some misrepresentation. Additionally, there seems to be a problem with the depiction of the economic phenomenon because all R&D expenditures are treated as if they result in future economic benefits. We conclude that full capitalization ranks low on freedom from error but fulfills the neutrality criterion. Both evaluations are entirely due to the fact that there is no flexibility for an entity to influence the accounting for R&D expenditures and, possibly, communicate private information about the respective R&D projects.

4.2.2 Full Expensing

Similar to the concept of full capitalization, preparers do not have an option to weigh or otherwise manipulate the financial information they report. Hence, expensing all R&D expenditures depicts the economic phenomenon neutrally. It seems noteworthy that full expensing represents a conservative accounting method (Flegm, 2004, pp. 102-3) because it understates income by expensing any R&D expenditures.

Regarding freedom from error, we can refer to our analysis of full capitalization. Reporting all R&D expenditures as expenses is at least partly erroneous because some of the R&D projects will produce future economic benefits. As a result, there is a misrepresentation when automatically expensing all costs while some economically beneficial discovery will be made. An economic assessment suggests that full expensing even more inadequately represents the underlying transaction since, on average, there should be more successful than unsuccessful projects. Otherwise, businesses would not spend money on R&D. In summary, full expensing produces neutral financial information, but is not free from error.

4.2.3 Contra-Equity Accounting

Regarding neutrality, we make similar points as for the two prior alternatives. To bridge the time of uncertainty concerning future economic benefits, all R&D expenditures are recorded in a contra-equity account, which is why entities do not have any potential to report biased information. Only when a project is successful[13] does the company reclassify the R&D project to an asset account.[14] Preparers do not have a choice regarding how to account for R&D expenditures and we consider the information neutral.

According to contra-equity accounting, R&D expenditures are first recorded as a reduction in ownership interest, while assets are displayed once it is certain that an R&D project is successful. Both depictions are free from error because, on the one hand, the contra-equity account reduces the ownership interest, which is a true depiction of the underlying economic phenomenon, at least at the time when R&D is performed and when it is uncertain whether the corresponding project is successful. On the other hand, the company's financial statements show an asset only if the R&D project has produced an asset.[15] Both depictions correctly represent

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[13] Johnson (1976), who suggested contra-equity accounting, is silent on how and when a project is considered successful. A distinction between successful and unsuccessful projects would need to rely on certain criteria, which, to be neutral, would have to be free from an entity's discretion. For example, a company could be required to provide evidence for a project's economic benefits, i.e. demonstrate realization.

[14] Reclassification takes place on a project basis and does not prescribe a measurement base. Instead, the value of the R&D asset would need to be assessed based on appropriate measurement concepts.

[15] Johnson (1976) proposed to report unsuccessful R&D projects as a capital loss in equity, implying that unsuccessful projects would never touch profit or loss. While there is no conceptual

the underlying transactions and we conclude that contra-equity accounting reports financial information that is free from error.

4.2.4 Partial Capitalization

Partial capitalization permits any treatment of R&D expenditures ranging from full capitalization to full expensing. The accounting is subject to the preparer's assessment of an R&D project or, more precisely, their assessment of the likelihood of receiving future economic benefits. To gain at least some neutrality, standard setters have introduced certain criteria to determine which portion of the costs should be capitalized.[16] To assess the neutrality of this alternative, we can use the FASB's rationale when it considered partial capitalization. In SFAS No. 2, the Board gives detailed reasoning as to why partially capitalizing R&D expenditures may not be neutral. Most notably, none of the criteria that the Board could potentially have used to distinguish between costs that need to be capitalized and costs that need to be expensed were considered objective. The FASB argued that companies would always be able and need to exercise judgment to determine the portion of R&D expenditures that can be capitalized. Hence, two companies that conduct similar projects would most likely not come up with the same portion of costs to capitalize because the companies would interpret the criteria in different ways. Thus, a subjective capitalization, or even an accounting choice on a case by case basis, results from partial capitalization. We are in line with the FASB's rea-

basis that contradicts such a treatment, there is a number of precedents for it, e.g., the accounting for revaluation surpluses under IFRS. However, if this form of accounting was considered undesirable, unsuccessful projects could be recorded as expenses later. This 'recycling' procedure has been employed for cash flow hedges.

[16] Under IFRS, abstract criteria are used to determine expenditures that can be capitalized (e.g. demonstrating the technical feasibility of completing the asset, IAS 38.57). The FASB, by contrast, prescribes exceptions for certain types of costs that can be capitalized, e.g., for developing computer software (SFAS No. 86).

soning and conclude that partial capitalization does not result in a neutral depiction of financial information.

The accounting method also accepts a misrepresentation of information in two ways. On the one hand, the question remains whether all R&D expenditures that are capitalized actually produce future economic benefits. Compared to full capitalization, the alternative likely reduces the number of capitalized unsuccessful projects. Nevertheless, some doubts remain as to whether all capitalized R&D expenditures relate to successful projects. On the other hand, partial capitalization depicts the underlying transaction inadequately because an entity capitalizes only a certain portion of total R&D costs. Thus, not all expenditures relating to a successful project are capitalized. To mitigate this finding, the FASB considered retroactive capitalization of the previously expensed costs. However, such a treatment would entail a distortion of prevailing financial reporting paradigms, according to which the initial accounting for transactions is not changed in hindsight. We follow the FASB's reasoning and conclude that partial capitalization is not free from error. Nevertheless, by distinguishing successful from unsuccessful R&D projects, the misrepresentation of the economic phenomenon seems to be lower than in the full capitalization or full expensing case.

4.2.5 Summary of First Level Analysis

In the course of our analysis, we aimed to expose the Boards' assertions used in the framework and supplemented these by assumptions and interpretations. On this basis, we were able to come up with an assessment of accounting concepts for the recognition of R&D activities.

Concerning relevance, we pointed out the Boards' assertion that financial information is relevant if the proposed concepts are in line with the definitions of the financial statement elements. An analysis still depends on how the definition and recognition criteria are comprehended. This issue foremost relates to the term 'probable' as a basis for the asset definition, which is not appropriately defined in the framework. Trying to make as few assumptions as possible and thus, for example, avoiding a decision on the relative importance of the financial statement elements, our analysis yielded that full expensing and contra-equity accounting present financial information of the highest relevance. Both alternatives suggest a treatment that is in line with the element definitions and recognition criteria presented in the conceptual frameworks, although contra-equity accounting could be subject to further analysis of 'other comprehensive income'.

Partial capitalization produces information to which we attribute somewhat lower relevance because uncertainty remains when entities partially recognize R&D expenditures as assets. Full capitalization cannot be assessed entirely because the uncertainty inherent in R&D activities can be completely deferred to the measurement of the R&D assets. In that case, the resulting assets may be relevant. However, since measurement is excluded from our analysis, full capitalization entails relatively high uncertainty regarding the probability of future economic benefits, which is why the portrayed financial information loses some of its relevance. Thus, in assessing full capitalization, it becomes most apparent that the term 'probability' is not defined properly. The resulting vagueness hinders a sound evaluation of relevance.

Regarding faithful representation, we first showed that completeness does not seem to contribute to standard setting decisions since the characteristic is achievable by adequate disclosure. We further assumed that restricting preparer's judgment by proclaiming a uniform treatment for all R&D expenditures fosters neutrality. Thus, full capitalization, full expensing and contra-equity accounting produce neutral information. By contrast, partial capitalization does not result in neutral information because preparers may influence the recognition of R&D expenditures. We regarded freedom from error as being essential for assessing whether the underlying transaction is accurately depicted. Contra-equity accounting does not produce misleading information, which would make this alternative preferable to the others. Full capitalization and full expensing perform lower because a relatively large misrepresentation results if all R&D expenditures are automatically capitalized (expensed) while there is evidence that at least some of the R&D projects are unsuccessful (successful). Partial capitalization performs lowest because it accepts misrepresentations of the underlying economic transactions in two dimensions.

Since it is unclear how the sub-categories of faithful representation are linked, we need to stick to the qualitative assessment made above. However, our analysis yields that contra-equity accounting performs best on faithful representation since it is at least as good as full capitalization and full expensing on neutrality and better than the other methods on freedom from error. Next, full capitalization and full expensing are comparable with respect to faithful representation as they perform similarly regarding neutrality and freedom from error. Partial capitalization performs lowest.

An overall assessment again depends on the way by which relevance and faithful representation are merged. Contra-equity accounting seemingly dominates other alternatives because the concept performs best with respect to relevance and faithful representation. Contingent on our assumptions, the concept would be the preferred accounting for the recognition of R&D expenditures. Full expensing is the second best solution as it is of higher relevance and of equal faithful representation compared to the next best alternatives. Both full capitalization and partial capitalization perform somewhat lower because full capitalization is less relevant but may be a better faithful representation than partial capitalization, and vice versa. Nonetheless, an assessment of relevance for full capitalization remains debatable.

4.3 Second Level Analysis

To further assess the alternatives, we address the second level analysis, which requires an analysis of the enhancing qualitative characteristics. Since only comparability is suited to distinguish between accounting alternatives, we limit the analysis to this characteristic. Given that we relied on assumptions on the first level and faced some discretion in the assessment, we conduct the second level analysis for all four accounting alternatives.

Since full capitalization satisfies both relevance and faithful representation, we can assume some degree of comparability (QC24). The method requires all companies to capitalize all R&D expenditures incurred in a particular year such that there is no discretion with regard to how the expenditures are treated. As a consequence, the financial information produced by full capitalization is comparable both between entities and over time.

This conclusion also holds for full expensing: Inter-period comparability is achieved as there is only one method to be used by entities. Inter-entity comparability is also assured because two entities facing the same situation end up with the same accounting treatment, which is immediately expensing all R&D costs. Full expensing thus achieves comparability and differs from full capitalization only regarding the section of the financial statements, i.e. balance sheet versus income statement, where investors obtain the comparable information on a company's R&D activities.

Contra-equity accounting also attains a certain degree of comparability due to its relevance and faithful representation. Comparability over time does not pose a problem as the entity has no options to change the accounting treatment from one period to another. Given that entities have no discretion concerning their assessment of success, inter-entity comparability is also fulfilled as different companies would need to treat similar situations alike. Subject to a unanimous definition of 'success of an R&D project', comparability would be given to the same extent as for full capitalization and full expensing.

Partial capitalization, however, would not necessarily result in a comparable treatment of transactions neither between entities nor over time since the method allows alternative treatments for the same economic phenomenon and introduces an accounting option that may be exercised on a case by case basis. What is more, companies could simply treat expenditures differently due to their different assessments of the R&D projects. As outlined above, this dilemma is not overcome by introducing additional criteria and the financial information portrayed by partial capitalization cannot be considered comparable (QC25).

As a result, full capitalization, like full expensing and contra-equity accounting, performs better on comparability than partial capitalization. Accordingly, the second level analysis suggests that full capitalization would overall be preferred to partial capitalization since its higher comparability makes it more decision-useful.

5 Conclusions

Our article examined the conceptual framework’s adequacy for solving recognition issues in standard setting. Based on a conditional-normative research approach, we examine traditional income measurement theories and decision usefulness approaches to come up with four accounting methods that the theories recommend for R&D: full capitalization, full expensing, contra-equity accounting, and partial capitalization. As a conditional element, we employ the qualitative characteristics of the conceptual framework to analyze the four accounting methods, which is an approach that both FASB and IASB assert to follow when formulating accounting standards.

Our analysis reveals that the Boards’ decision making tool features inconsistencies and several deficiencies. Foremost, we find that the qualitative characteristics are inadequately defined and thus often require interpretation. While we come up with a recommendation regarding the recognition of R&D projects, contra-equity accounting, our analysis relies too much on assertions made by the Boards and own assumptions that it can hardly be seen as an input to the Board’s political and pragmatic standard setting process.

As a result, we conclude that in its current form the conceptual framework is not suited to help standard setters make deductive recognition decisions that refer to self-constituted quality criteria and are comprehensible by third parties. We offer two explanations for this result: First, the Boards do not use the conceptual framework for solving standard setting questions but approach issues on a standard-by-standard basis. To paraphrase Storey and Storey (1998, p. 50), assets are whatever the Boards or the standards say they are. Possibly, the debates between board members as well as political forces may prove too strong for a standard setting regime to be conceptually consistent. As a result, the framework may give Board members only rough ideas or guidelines on self-prescribed criteria that are useful as a reference frame. In that case, it would not be a deductive basis for deriving accounting solutions and a normative analysis such as ours would not be suited to assess accounting methods. Alternatively, the qualitative characteristics are only used at the margin, i.e. to stress a particular point when assessing different methods. The lacking hierarchy of elements and the relatively vague evaluation process support this assessment. It could also be the case that the qualitative characteristics merely state *which* financial information should be reported and not *how* or that the characteristics were mainly made for preparers to provide them with guidance on how to resolve not yet regulated accounting matters. Overall, it is not clear which approach dominates since the guidance to the characteristics is inconsistent and implies either multiple uses or lack of awareness of inconsistencies. As a consequence, the true purpose of the qualitative characteristics remains somewhat in the open.

Our second explanation suggests that the Boards do use the framework when setting standards but have a different understanding of it than was used in our analysis. Consequently, the Board members would have more precise and better defined qualitative characteristics in mind than are written down (Horngren's (1981) 'individual conceptual frameworks'). Considering that the FASB's framework was criticized as being too detailed, we suppose that the Boards, aiming to adhere to this critique, made the revised framework less wordy. However, while eliminating some of the detailed descriptions, the Boards did not erase their understanding of the characteristics. As a consequence, more detailed – 'historical' – definitions could still be valid, e.g. in the case of 'bias'. An interpretation close to the framework's actual text may thus produce different outcomes compared to the Boards' analysis. As a result, we may conjecture that the conceptual framework is not an objective evaluation tool because it is not written as such. Possibly, the standard setting's political process may have further watered down the evaluative power of the framework.

Failure to achieve operationalization of the framework implies that the characteristics and definitions are concepts without an apparent meaning. In addition, the inability to use the framework suggests that the qualitative characteristics are dispensable or as Macve (1997, p. 76) points out for the FASB's revised framework: '[D]efining usefulness in terms of say 'relevance' and 'reliability' only shifts the area of disagreement over any particular problem back from 'Is this information useful?' to 'Is this information reliable?' or 'Is it relevant?''. As a result, the introduction of qualitative characteristics would 'merely lead to word-shuffling' (Macve, 1997, p.76). Such a conclusion weighs heavily on the standard setters, all the more when considering that the Boards are aware of the need for a coherent foundation of accounting standards: 'Standard setters cannot fulfill their missions without a sound and unified conceptual underpinning that guides and provides discipline to decisions about whether one solution to a financial reporting issue is better than other potential solutions' (IASB, 2006, p. 16).

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IV.

THE REGULATION OF ASSET VALUATION IN GERMANY

MANUSCRIPT C.

Dr. Sebastian Hoffmann
Assistant Professor
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: sebastian.hoffmann@hhl.de
tel. +49 (0) 3 41 – 9851 708

Dominic Detzen
Research Associate
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: dominic.detzen@hhl.de
tel. +49 (0) 3 41 – 9851 670

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V.

On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism

Manuscript D.

Dominic Detzen
Research Associate
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: dominic.detzen@hhl.de
tel. +49 (0) 3 41 – 9851 670

Dr. Sebastian Hoffmann
Assistant Professor
HHL Leipzig Graduate School of Management
Chair of Accounting and Auditing
Jahnallee 59, D-04109 Leipzig
email: sebastian.hoffmann@hhl.de
tel. +49 (0) 3 41 – 9851 708

We thank Hans Göschel for granting us access to the vast amount of information he collected over numerous years on the Handelshochschule Leipzig. We also thank the staff of the University of Leipzig archives.
References to 'he or she' will be avoided; instead, 'he' will imply 'he or she'.

V. On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism

1 Introduction ... 190
2 Germany's Business Schools and HHL from 1898 to 1933 ... 195

2.1 The Evolution of German Business Schools: 1898 to 1930 ... 195
2.2 Focusing on Professional Accountability: 1930 to 1933 ... 197

3 *Gleichschaltung* of Charters and Regulations: 1933 to 1935 ... 203

3.1 First Steps towards Coordination: 1933 ... 203
3.2 Dissemination of the Ideology: Aryan Faculty, Party Membership and Denunciations ... 207
3.3 Implementing New Forms of Accountability: 1934 to 1935 ... 211

4 Dispersion of Accountability: 1935 to 1945 ... 218

4.1 Major Changes of HHL's Faculty: 1935 to 1937 ... 218
4.2 A Zealot Hands Over to a Liberal: 1937 to 1939 ... 223
4.3 Hasenack's Opposition in Times of War: 1939 to 1944 ... 228
4.4 Outlook – The Regime's Dissolution: 1945 ... 232

5 Conclusions ... 234

On the Ubiquity of Accountability – The *Handelshochschule Leipzig* in the Claws of Nazism

Abstract

In this article, we study the concept of accountability under extreme societal conditions as imposed on Germany during the Nazi regime from 1933 to 1945. The Nazi ideology penetrated the entire society and caused, deliberate or reluctant, change of organizations, institutions and people. We refer to the *Handelshochschule Leipzig* as the oldest business school in Germany to show how the Nazi doctrine found its way into an institution of higher morality, which universities tend to represent. While demonstrating that every aspect of the school's routines was affected, we find that the occasional opposition to the regime was smothered by widespread actual or nominal loyalty. Due to the regime's paranoia, political accountability became a ubiquitous and dominant governance instrument, influencing individuals by threatening their moral integrity and corrupting the personal conscience of the accountable self.

Keywords: Accountability, Nazism, Business Schools, History

1 Introduction

Ever since Scott and Lyman (1968) analyzed the employment of statements "to explain untoward behavior and bridge the gap between actions and expectations" (p. 46), the concept of accountability has been extended to large parts of society. It is "one of those golden concepts that no one can be against" (Bovens, 2007, p. 448), since, broadly speaking, it helps interested parties to obtain an understanding of whether and to what extent an accountable self deviated from a target imposed on it. By making someone take responsibility for his actions and thus for deviating from a previously specified target, accountability influences behavior and decisions. The psychological effects of the concept have long been acknowledged (Lerner and Tetlock, 1999), although only recently the ethical problems of accountability were exposed (Messner, 2009).

Given that there is no universal definition of accountability (e.g. Sinclair, 1995), we use the term to signify how the accountable self responds, or communicates his response, to duties externally imposed on it. The concept is divided in three dimensions: political, professional and personal. The political domain exclusively consists of obligations set by the state or politically affiliated organizations or individuals. The accountable self's ethical and moral standards and beliefs determine what we label personal accountability. The professional dimension entails "the sense of duty that one has as a member of a professional or expert group" (Sinclair, 1995, p. 229). As will be shown, the dimensions tend to blur, especially due to the extreme demand of political alignment required from individuals.

This article is an attempt to further our understanding of the limits of accountability by examining how extreme societal conditions, as exhibited in Nazi Germany between 1933 and 1945, change the norms which the accountable self needs to comply with. In addition, we show how the fear of penalization caused the accountable self to betray its personal conscience by forcing it to adhere to the norms imposed on it or, in turn, by exploiting the ideology for its personal benefit. We extend Messner's (2009) discussion of the ethical limits of accountability by providing insights into the use and abuse of accountability in a dogmatic society. In particular, we show that, at the margin, accountability is an all-encompassing instrument supporting overly suspicious or paranoid leaders of a centralistic or dictatorial system or organization, at the same time changing individuals' beliefs or behavior.

Early on in their regime, the Nazis implemented a new bureaucracy on top of existing structures, creating an inefficient apparatus of overlapping and confusing controls (Temin, 1991). Aiming at entrenching their ideology throughout society, every aspect of public and private life was penetrated with vehement propaganda. The regime needed to assure that people and organizations were politically aligned in everything they did and thus created strict reporting and control mechanisms. By doing so, the system contributed to a change in individuals' moral integrity and ethical values by sanctioning any form of non-compliance with the newly established norms and, in turn, rewarding those who helped identify cases of non-compliance. Traditional societal and organizational hierarchies diffused because of the newly introduced bureaucracy, which featured a clear line of command, as well as due to the denouncing mechanism, which ran in all directions. The ubiquity of accountability thus contributed to further entrenchment of the regime's ideology and avoidance, or strong decline, of resistance. The result was what Butler (2005) designated "ethical violence": the accountable self was threatened by severe sentences, such as becoming a social outcast, losing its job, even imprisonment, deportation and death. Consequently, it was strongly incentivized to betray its personal conscience and adjust its behavior, aligning it with the political norms. While ethically tormented, it tended to justify its behavior with the fear of the consequences of opposition. Eventually, the accountable self became part of and strengthened the system.

Academic organizations, in particular universities, are generally considered institutions of high morality, tending to respond with hesitance to politically driven ad hoc changes in society's moral standards (Rorty, Reuben and Marsden, 2000) and responding slowly to such externalities. Due to this characteristic, universities provide an ideal setting for studying accountability in extreme societal conditions. We examine to what extent the Nazi regime penetrated educational institutions by investigating changes in the schools' regulations, reporting and recruiting as well as publishing and educational behavior. We argue that political accountability became ubiquitous and thus a moral burden for anyone not willing to align with the Nazi ideology.

For our analysis, we chose the *Handelshochschule Leipzig* (HHL) as an example for two reasons. First, being founded in 1898, HHL was the first business school in the German-speaking area. As such, it was the alma mater of numerous business scholars of the first generation; its most prominent alumni include Eugen Schmalenbach, Fritz Schmidt and Heinrich Nicklisch. The school thus left a considerable mark on the discipline of *Betriebswirtschaftslehre* (business economics) in Germany. Second, after receiving the *Promotionsrecht* (right to confer doctorates) in 1930, HHL became an established and reputable business school with university rank that, nonetheless, was constantly threatened in its independence due to its relatively small financial endowment. As a result, it held close ties with the University of Leipzig, e.g. by sharing classes and lecturers. The school stands *pars pro toto* for the impact of the Nazi regime on business schools in Germany[1] in that HHL was not one of those institutions extraordinarily affected by the regime (Mantel, 2009, p. 225).

We organize our study around the festivities for the inauguration of the new dean, during which the outgoing dean gives an account of his term in office. Following Sinclair (1995, p. 224), the official ceremonies allow us to observe the structural component of accountability, which is rational and delivered since it can be worked with and controlled. These accounts are supplemented by episodes that are to serve as an illustration of the widespread demand for accountability and its contrast to the individual's moral and ethical dimensions of this concept. Referring to Sinclair's (1995, p. 224) personal notion, the anecdotes show the ambiguity of accountability, how the concept itself is feared and the accountable self is vulnerable to it.

Our study is mainly based on primary source material from HHL's archive.[2] In particular, we accessed the proceedings of the inauguration festivities, the staff

1 This study is not intended as a comprehensive review of the effect of the Nazi regime on business professors or business schools (see, e.g., Gmähle, 1968; Hundt, 1977, ch. 3; Schneider, 2001, pp. 216-237; Mantel, 2009).

2 HHL's archives are part of the archives of the University of Leipzig (UAL) and are registered under the shelf marks HHS 1 to HHS 640. For the sake of readability and brevity, we do not include the references to the archival material in the text.

records of the deans as well as their denazification files[3], charters and regulations during that time as well as correspondence regarding these, minutes of the school's decision-making bodies and deans' correspondence, course catalogues, and, as far as available, professors' correspondence and publications. Secondary sources, particularly other scholars' research on Nazism and universities supplemented this database.

We proceed as follows: After briefly introducing the emergence of business schools in Germany, we describe HHL as it entered the 1930s, starting with the celebration of its receiving the *Promotionsrecht*. This section portrays the business school under "normal" circumstances, not influenced by extremist thinking. In subsequent chapters, we describe how the Nazi ideology, especially the so-called *Gleichschaltung*, i.e. the process of coordinating all aspects of public life with the Nazi doctrine, influenced HHL's formal accountability as set out in the school's regulations. Next, we examine the time until the end of the Nazi regime, during which accountability largely dispersed. In a final section, we summarize our findings.

[3] These files were written post-World War II and were to demonstrate a person's resistance to the regime. We are aware that the documents themselves represent "accounts", used to whitewash the accountable self, and thus need to be considered with some qualification.

2 Germany's Business Schools and HHL from 1898 to 1933

2.1 The Evolution of German Business Schools: 1898 to 1930

While not necessarily instigating the development of *Betriebswirtschaftslehre* as an academic discipline, the formation of the German *Handelshochschulen* (colleges of commerce) played a major role in its evolution. Starting in 1898 with HHL, a number of business schools were founded in the German-speaking area.[4] The schools primarily aimed at increasing merchants' knowledge, in particular in the areas of languages, economics and law, whereas commercial or business-related education gained importance only over the years (Schneider, 2001, p. 192). Moreover, the quality of the education as well as the admission criteria varied widely among the business schools such that they were seen as universities in the second or even third tier for a number of years (Mantel, 2009, p. 16). As a consequence, the *Handelshochschulen* initially did not have the *Promotionsrecht* and, many being under supervision of the local Chambers of Commerce, lacked full academic independence.[5] Only when allowed a *Rektoratsverfassung* (dean's constitution), which entitled the school to elect an academic dean from among its faculty, and granted the *Promotionsrecht* were the schools considered of university rank. This evolution occurred largely simultaneously to the rise of *Betriebswirtschaftslehre* as an academic discipline.[6]

4 To name but a few, these include Aachen, St. Gallen and Vienna in 1898, Cologne and Frankfurt in 1901, Berlin in 1906 and Mannheim in 1908.

5 The business school in Cologne was the first independent *Handelshochschule*, having received a large financial endowment from entrepreneur and politician Gustav Mevissen.

6 According to Schneider (2001, p. 201), the "breakthrough" of business administration were scholars' suggestions and approaches to account for the effects of the early 1920s hyperinflation. Throughout that decade, business schools' constitutions were reformed and *Handelshochschulen* started to obtain the *Promotionsrecht*, inter alia at the initiative of Heinrich Nicklisch (Schneider, 2001, p. 210).

The *Handelshochschule* in Leipzig, like its peers, started out modestly by renting classrooms from other schools and by having its students attend courses from the University of Leipzig since HHL did not have its own lecturers.[7] Over the years, the resources of the school increased and it saw the creation of an *Institut für Revisions- und Treuhandwesen* (institute for auditing and fiduciary activities), which began its operations following the creation of a *Bücherrevisorenkurs* (seminar for chartered accountants) in 1907. Other institutes followed, e.g. one for taxation in 1920 and one for world economics in 1924.

HHL gained full administrative independence in 1911 when it became a legal person under public law, but gained a *Rektoratsverfassung*, i.e. academic independence, only in 1923. From that time on HHL was under the supervision of the *Sächsisches Wirtschaftsministerium* (Saxonian department of economics). According to the new *Rektoratsverfassung*, the *Rektor* (dean) was elected from among the regular professors for two years and was to conduct the everyday business of the school. The *Professorenrat* (council of professors) consisted of all full, adjunct and honorary professors as well as three representatives of the other lecturers and took the major decisions mainly regarding teaching and research. Finally, the *Senat* (senate) carried out the tasks of a supervisory board. Following a constitutional reform in 1931, the *Professorenrat* was renamed *Senat* and the former *Senat* was labeled *Kuratorium*, while their duties remained unchanged.

HHL's faculty, like any school's, was made up of teaching and research staff at various levels of their career path. Typically, after having obtained a doctorate, a

[7] This and the following paragraph draw from Grossmann (1950), who characterizes the beginnings and the evolution of HHL from 1898 to 1946. Grossmann was not only a professor at HHL for 22 years, but, having enrollment ID 74, also one of its first students.

lecturer became assistant to a full professor, pursuing his *Habilitation* or *venia legendi*, a post-doctoral degree necessary to become professor at a university. Having obtained this degree, the assistant was awarded the title *Privatdozent*, which allowed him to give classes independently, approve examinations and supervise research without holding a professorship. Afterwards, they became *nicht-planmässiger ausserordentlicher Professor* (extraordinary adjunct professors), which was a non-tenured teaching position without a regular salary. A *planmässiger ausserordentlicher Professor* (ordinary adjunct professor) had a paid position without any or with only few research assistants and a lower budget than a *planmässiger ordentlicher Professor* (full professor), which was the highest position in German academe. Besides these positions, *Lehrbeauftragte* (lecturers) were often recruited from practice and supplemented the classes given by regular faculty members.

2.2 Focusing on Professional Accountability: 1930 to 1933

For a long time, HHL was not successful in its attempts to obtain the *Promotionsrecht* on the grounds that the school's alumni could go to the University of Leipzig to pursue a doctorate (Grossmann, 1950, p. 37). It was only on 13 May 1930 that HHL received the *Promotionsrecht* as the penultimate business school in Germany[8] and became a recognized academic institution of the same status as a university. The business school had successfully added to its business faculty and amended its study regulations to demonstrate that, from a scientific standpoint, *Betriebswirtschaftslehre* was on par with economics. Accordingly, a ceremony was held on 2 July 1930 in Leipzig's old theatre, when the chairman of HHL's

8 Königsberg obtained the *Promotionsrecht* only a few months later.

senate, a director from the *Sächsisches Wirtschaftsministerium*, the dean of the University of Leipzig, the mayor of Leipzig, the student's representative and HHL's dean gave speeches.

While these talks were not necessarily to report on past developments, the representatives of HHL felt obliged to justify why the school obtained the *Promotionsrecht*. As a result, the speeches display a high level of professional accountability and thus give an indication of accountability practices in the pre-Nazi era. The chairman of HHL's *Senat*, Richard Schmidt, asserted that the socio-political environment further emphasized the need to establish *Betriebswirtschaftslehre* as an academic discipline. He pointed to a draft for a Stock Companies Act, which was about to be published and which, inter alia, expanded the role of "highly qualified economic trustees, which assume legal functions."[9] Since Germany lacked these experts, Schmidt argued that "they are needed in great numbers and have to be educated quickly. What prospects these are for our students! […] To educate them at our school, we have the most favorable conditions, after we have expanded and specialized our faculty and created new useful facilities to obtain the *Promotionsrecht*." Similarly, he pointed to the benefits for students' careers: "Once, every one of Napoleon's soldiers had a marshal's baton in his knapsack. Likewise, each of our students will have his mortarboard in his wardrobe. […] However, only the most able, industrious and capable will obtain that decoration." Despite the military notion of this comparison, Schmidt focused on the academic advances gained over the years. He urged professors and students to go on in their striving for academic excellence thus committing every member of the school to safeguard the

[9] All German excerpts were translated as closely to the original German text as possible. For reasons of brevity, the German passages are not provided.

conditions that are necessary to maintain university rank. He closed his speech by referring to a new flag hoisted at HHL, whose “contemporary and always genuine motto will guide [the school]: ‘Trade unites the nations.’” This open-minded remark and the general positive tone were repeated in subsequent speeches and give testimony that the school, like its supporters, was dedicated not only to the school and their tasks but also to the advancement of *Betriebswirtschaftslehre* as an academic and international discipline. Professional accountability to further knowledge and the standing of academe was the focal point of the schools’ role in society.

Hermann Grossmann, then the dean of HHL,[10] gave the official speech for the occasion on the synthesis of the economy and science. Grossmann’s elaborations are a convincingly presented plea for the need of education in social, economic and political dimensions. Grossmann repeatedly referred to the term *Führer*, which was not yet a synonym for Adolf Hitler, but was frequently used in an economic context, e.g. to talk of business leadership.[11] The dean asserted that “the German people has sustained its position as the intellectual *Führer* of the world” and “the German intellect will not slow down in its wish and urge to explore in order to do great things for the true blessing of the German economy and the true welfare of mankind.” Nationalistic statements such as these were common at the time but had not yet taken the extremist notion of a few years later. Accordingly, the dean emphasized the merits of academe and intellectual work, regarding the education of effective business leaders as a central pillar of a school’s work and

[10] The appendix includes a list of HHL faculty from 1933 to 1945.

[11] Prior to his speech, Dean Grossmann awarded Richard Schmidt a doctorate *honoris causa* and praised him as “the proven *Führer* of the economic area of Leipzig.”

society's success. Like Schmidt, he seemed to view academe as a competitive environment, in which HHL would operate on a level playing field, further striving for academic excellence and proving itself worthy of its newly obtained status.

Grossmann's term as dean ended on 31 March 1931, when another opportunity was given to observe accountability practices.[12] Traditionally, the school held festivities for the inauguration of a new dean, in this case Alexander Snyckers, at which the outgoing dean reports on major events of his term. In 1931, these festivities took place on 3 June and Grossmann was the first to speak, emphasizing the need to look back and give an account of his deanship. He identified HHL's obtaining of the *Promotionsrecht* as the dominating event of his term and reported only factually about all other important developments regarding research, teaching and administrative activities, nonetheless documenting HHL's ability to perform well in these areas. His term was further characterized by an extraordinarily strained economy in the aftermath of the Great Depression such that he also struck some negative notes regarding the school's funding. Given that these were the only critical issues he mentioned, Grossmann seemingly attempted to position the school well and, in light of the attendance of all deans of academic institutions in Saxony, impress his colleagues by documenting excellence in all academic areas. Handing over the office to Snyckers, Grossmann concluded: "I present your Magnificence the constitution of our school, which you are required to guard. May the burden of the office bring you satisfaction in your successful endeavor to the benefits of our school. May God grant it." In his final words as dean, Grossmann em-

[12] To award Grossmann for obtaining the *Promotionsrecht*, he had been given a second two-year term, which he did not complete on health grounds. The dean's terms coincided with traditional school terms: The Winter term ran from 1 October to 31 March, while the Summer semester ran from 1 April to 30 September. Teaching typically began on 15 October and 15 April, respectively, and lasted over 14 to 15 weeks.

phasized the office's dedication to the advancement of the school within the limits of the law, clearly appealing to the dean's accountability.

Alexander Snyckers' speech on *"Statisches und Dynamisches in deutscher und französischer Wesensart"* ("On the Static and Dynamic Nature of the German and French Culture") was intended to make apparent distinctions between the French and German society and, to a large extent, represented a factual assessment of the topic. In concluding, Snyckers characterized the French as the more static nation – static being understood as balanced, favoring the status quo – and the German people as the more dynamic one – i.e. being in motion, being driven, advancing, but also being uncertain. By implying superiority of Germany over France, Snyckers' speech featured a nationalistic tone that becomes more severe towards the end. Emphasizing that Germany's colonies had been taken away following the war, he claimed that the German people did "not have sufficient space to live", which later became an argument used by the Nazis to justify the expulsion of people from Eastern Europe. Concluding his speech, he warned of rising conflicts in Germany that may also endanger the rest of Europe: "And the excessive dynamic, which the German people unwillingly were pushed to as a result of the peace treaty [of Versailles] and its catastrophic consequences, are not constructive anymore, but lead to increasingly severe social turmoil. Those fights are not only an enormous danger for Germany, but for the whole of Europe. And that is something that the countries that are currently in power should think about instead of pushing our German nation further into disaster by their lack of understanding for the difficulty of our situation. That is what they should consider, not only in our, but also in their own interest."

Snyckers' posture was considerably different from the one of his predecessor. Had Grossmann avoided much political notion in his addresses did Snyckers now conclude with a political statement that bordered on a threat to other countries. Snyckers, who was born in Belgium, had worked for the press department of the German general governor in Brussels in World War I when Belgium was occupied by Germany. Possibly, this involvement in the military and politics made him take a more militaristic stance compared to Grossmann, who was never politically active or involved in either of the world wars.[13] Thus, their understanding of the dean's political role may have differed, although both were subject to the same political environment when Germans were getting increasingly anxious of their economic situation.

[13] Grossmann's political involvement was limited to his friendship with Gustav Stresemann, a Nobel Peace Prize laureate and foreign minister, who in 1923 served as *Reichskanzler* when Adolf Hitler's Munich Putsch failed.

3 *Gleichschaltung* of Charters and Regulations: 1933 to 1935

3.1 First Steps towards Coordination: 1933

Being appointed Chancellor of the German *Reich* on 30 January 1933, Adolf Hitler quickly took a number of measures to entrench his position and to suspend democratic principles in Germany. Over the course of the next two years, Hitler seized, inter alia, the power to issue laws without parliamentary involvement, abandoned the constitution, deprived the German states of most of their legislative powers, outlawed or restricted parties other than his *Nationalsozialistische Deutsche Arbeiterpartei* (Nazi party, NSDAP), and suspended or restricted numerous human rights. Centralizing power was a key feature of Hitler's regime and was implemented by the *Führer* principle throughout every aspect of public life. The Nazi-driven understanding of the term *Führer* based on two main aspects (Gmähle, 1968, pp. 230-231): First, referring to Darwinism, the strongest or best man would emerge and lead. Democratic principles were in the way of the *Führer*'s reign. Second, given his strong personality, the *Führer* was solely in charge and, while relying on other institutions for advice, took all decisions himself. As a result, the *Führer* had authority towards his subordinates and was strictly accountable to his superiors. Implementing the *Führer* principle throughout all organizations and institutions by issuing laws, orders and directives gave the regime total control and introduced strict hierarchical accountability coordinating the entire society in line with the regime's principle ideology.

Like any other university, HHL was subject to the political change as well, which can be observed during the subsequent festivities for the new dean's inauguration.

On 14 June 1933, Dean Snyckers reported on his term lasting from April 1931 to March 1933 and handed over his office to Gerhard Wörner. The political rhetoric Snyckers had displayed in his 1931 report continued on this occasion and was further enriched by ideology. He explicitly welcomes the mayor as the *Führer* of the city, the *Führer* of the local *Sturmabteilung* (SA, storm troopers) and other military and paramilitary organizations, giving an indication of the political change. Snyckers compared the school's current situation to the one a decade earlier, finding that the year 1923 had been characterized by significant material distress and widespread despair. Ten years on, the economic situation was still very difficult but "the German people believes in the future again. Today's omnipresent optimism […] emerges from the awareness that, although there is still some considerable rebuilding to do, due to its new leadership the German nation has the power to accomplish its mission. […] Given the developments of the recent months, we are confident in a bright future, in which our business school will also contribute to the reconstruction of Germany." The nationalistic introduction of the speech conveys the impression that the political change had casually changed the minds and feelings of people, or at least made their previously held beliefs apparent. Snyckers reinforced this notion by stating that "through the gates of our school, the wave of the national movement has also flowed. Hoisting the black-red-white [flag] and the swastika was the symbol for this. A symbol, which, so far, signals readiness and hopefully soon fulfillment." Besides honoring national and political symbols, he encouraged faculty members and students to join him in this new spirit of optimism and enthusiasm for the regime, requesting them to politically align: "All of you know the plans for a 'political university' […]. And it will only be possible for HHL to maintain its standing among the universities, if it gets involved in the process of renewing and transforming university education." Snyckers' announcement and plea to the school's constituents demonstrated not only political alignment, but showed that a new variable had entered the competition for academic excellence. Schools' objectives started to modify and their professional accountability seemed to increasingly include a political component. His call for political alignment also aimed at sustaining HHL's independence, for which he considered political engagement necessary.

In his speech, Snyckers noted several organizational changes that resulted from amendments to HHL's regulations and statutes, due to which e.g. the *Senat* was re-named *Kuratorium*. Although the outgoing dean emphasized that neither the school's constitution nor the regulations for the habilitation were affected, he did not mention his attempt to change HHL's constitution at the end of 1932 when he prepared a handwritten draft that showed his ideas of an early political alignment. Inter alia, he proposed to make the dean the *Führer* of the school with sole and comprehensive authority. However, Snyckers' efforts were silenced by the meeting of the *Kuratorium* on 5 January 1933, which refused to accept his constitutional draft. It seems likely that Snyckers was an early follower of the Nazi ideas. However, his failure and his disregarding of the episode suggest that the Nazis had not yet cemented their power. Instead, Snyckers, relegating other issues, such as lectures or funding, to an appendix, wished the incoming dean well, hoping that "all parts of the school will work together for the advancement of the scientific research and education, which we serve." Again, while demonstrating his political attitude, Snyckers' speech does not imply that the Nazis were as entrenched yet. Professional accountability still related to academic advancement and education. Nonetheless, it seems that by 1933 political aspects started to encroach on the school's conduct of business.

Supporting this notion, Dean Wörner underscored in his otherwise balanced speech, entitled “*Wesen und Quellen der Versicherungsbetriebslehre*” (“Nature and Sources of the Management of Insurances”), that his role as university teacher was in line with the above-cited *Führer* principle, which Wörner called “generally accepted by now”.[14] His job was “to find the one among the many aspirants and prepare his path for *Führung* (leadership). It is the fortune of a professor to find the one, to support the one, who once will be called to be a *Führer*.” Wörner, who had fought in World War I from 1914 to 1918, was the founder of the Leipzig chapter of the *Stahlhelm* (steel helmet), a paramilitary organization of war veterans. His militaristic tone is thus not surprising and seemed like a foreboding for the political alignment HHL, like other schools, was due to undergo.

In their hastening to follow the new regime, Snyckers and Wörner were not alone. Numerous scholars of all academic disciplines had signed a “vow of allegiance of the professors of the German universities and high-schools to Adolf Hitler and the national socialistic state”, which was proclaimed on 11 November 1933 in Leipzig. In their pledge, which was translated into English, Italian, French and Spanish, the professors appealed “to the intelligentsia of the whole world to cede their understanding to the striving German nation – united by Adolf Hitler – for freedom, honor, justice and peace, to the same extent as they would for their own nation.” HHL’s entire faculty signed the pledge, which, however, cannot necessarily be regarded as a sign of political commitment. According to Mantel (2009, p. 567), some schools’ deans insisted that all professors sign the vow to politically

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14 This conclusion seems a little premature since the *Gleichschaltung* had not been fully developed. Most likely, Wörner referred to his own political beliefs giving the regime a vote of confidence.

align their school.[15] Although we do not have evidence that the latter was the case at HHL, it is possible that Dean Wörner solicited all professors' signatures because, later on, he also "encouraged" HHL professors to join Nazi associations (see below). The vow of allegiance stands as early evidence for professors' changing their moral beliefs, or hiding their true beliefs by committing themselves to a despicable political regime to not endanger their careers.[16]

3.2 Dissemination of the Ideology: Aryan Faculty, Party Membership and Denunciations

A major reason to align politically had been given to professors on 7 April 1933 when the *Gesetz zur Wiederherstellung des Berufsbeamtentums* (law for the reestablishment of the public office) was issued. According to this regulation, *Beamte* (tenured civil servants), such as professors, could be fired to simplify administration and reestablish a *national* public office. Reasons for dismissal or early retirement were inaptitude, non-Aryan ancestry and political unreliability.[17] An exception for the dismissal due to non-Aryan lineage was made only if a civil servant had been in office prior to World War I, had fought in the war or if his father or son was killed in the war. Having served the national interest thus saved people from the ideology, again pointing to the militaristic notion of the time.

15 Ironically, the vow begins with a statement by the *Führer* of the Saxonian teachers who emphasized that the professors "willingly and deliberately" aligned with the party.

16 However, this trend was not yet visible everywhere. For example, the *Festschrift* for the tenth anniversary of HHL's institute for world economy by Haushofer and Vogel (1934), entitled *Weltwirtschaftsdämmerung* (the world economy in the twilight), did not contain an obvious Nazi slant. Instead, the title was chosen to signify the challenges experienced in previous years and the looming changes for the world economy.

17 The definition of Aryan lineage remained unclear until the infamous Nuremberg laws were passed in 1935.

Against this background, HHL in 1933 acted to “free” its faculty from non-Aryan lecturers. Siegfried Berliner, who taught at HHL from 1908 to 1913 and since 1928, was not able to renew his teaching assignment following a letter from the department of education to HHL on 25 April 1933.[18] In a similar vein, Hans Kirchberger had been teaching as *Privatdozent* since Summer 1927 and as *nicht-planmässiger ausserordentlicher Professor* since Summer 1931. In its deliberations on 10 May 1933, the *Senat* decided against renewing Kirchberger’s teaching assignment because of his non-Aryan lineage. While having been in the military in World War I, his file did not show that he participated in a battle, which for the *Senat* was reason enough not to keep Kirchberger on the faculty. On 11 July 1933, the dean reported to the department of education that two non-Aryan lecturers had been dismissed and that the school now featured an Aryan faculty.

HHL’s remaining faculty members had to adjust, if necessary, to the new reality. Several professors were “encouraged” to join the NSDAP or show some other sign of support for the regime. For example, Dean Wörner approached Hermann Grossmann as the senior member of HHL’s faculty to join the party “in the interest of the school”, which Grossmann did on 1 May 1933.[19] Similarly, Walther Löbner, at the time writing his habilitation, joined the party, being instigated by “his tutor and father-like friend” Professor Karl von der Aa to “strengthen the party’s decent elements.”[20] Karl Thalheim, at the time *nichtplanmässiger ausser-*

[18] Schneider (2001, pp. 223-224) and Mantel (2009, p. 373) assert that Berliner continued to teach evening classes at HHL until 1938. Based on HHL’s course catalogues, which list Berliner as *Lehrbeauftragter* until 1933, we were not able confirm this piece of information.

[19] Or so Grossmann claimed in his eight-plus pages report on his behavior during the Nazi regime. He asserted that “at that time, every German could consent with good conscience to the party’s efforts”, which, in retrospect, seems an illusory claim.

[20] Letter from then-Dean Lütge to the regional government, dated 22 November 1945, to keep Löbner in office.

ordentlicher Professor, claimed that he was approached both by the *Führer* of the lecturers at the University of Leipzig and the *Führer* of the student body at HHL to show a sign of loyalty to the regime. Otherwise, his university career would be in peril, which seemed plausible given that Thalheim had repeatedly criticized the Nazi ideology between 1930 and 1933 and had in 1930 run for the Saxonian state parliament on the ticket of a liberal party. To avoid this consequence, he joined the SA, choosing "the lesser of the evils."[21]

A somewhat absurd account is given by Wilhelm Hasenack, who joined HHL only in 1938 and who in 1933 was a *planmässiger ausserordentlicher Professor* at Technical University of Berlin (TUB). Along with his wife, he had been photographed at a ceremony not singing along and not showing the Nazi salute. Upon the urging of TUB-Dean von Arnim, himself a major SA figure, to enter a party organization, Hasenack joined the SA as "the mildest form of showing a party relationship". When recruited to HHL, Hasenack was encouraged by Dean Snyckers to join the NSDAP because the local government would not approve a non-party member. These anecdotes demonstrate that career concerns, in particular of younger scholars, were exploited by Nazi followers to instigate party membership or other forms of commitment to the regime. The threats implemented by the regime seemed to work as they resulted in a political alignment, at least on a formal level, of many individuals. Likewise, the pressure by superiors or other followers of the regime displays a form of universal accountability in that anyone could be required to align or else. As a result, the anecdotes suggest that party

[21] In a letter to the regional government, dated 22 November 1945, Lütge claimed that Thalheim joined the SA because admission to the NSDAP had been restricted.

membership can *ex post* not be regarded as a sufficient instrument to discriminate between nominal and actual Nazi followers.[22]

While it seemed that being loyal to the Nazi regime would be a job guarantee, there is an episode surrounding Franz Findeisen, professor for merchandise and advertising, which gives testimony to the contrary. Findeisen, who in the early 1920s became a respected scholar publishing on a wide range of topics, had been on medical leave in 1927 due to being diagnosed with schizophrenia. Upon his return, he asserted that he, along with Professor Ernst Schultze, was discriminated against by HHL's faculty. After the Nazis had taken over, he saw his chance for payback, claiming that he had been a Nazi follower for a long time.[23] He appealed to the local Nazi administration that HHL lacked commitment to the new regime and that he was discriminated against because of his political beliefs. A member of the state parliament replied to the school on 18 July 1933 listing numerous questions that reiterated the professor's claims and doubted the school's political alignment. One of the issues concerned Findeisen's allegation that the habilitation of his assistant, Curt Sandig, was "communistic". Claiming that all assistants were "lice", Findeisen had refused to sponsor the work.[24] Only later did he "substantiate" his claims accusing Sandig of quoting from Jewish sources.[25]

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[22] Hermann Grossmann later in his report demanded that the question should not be "party member or not", but "guilty or not". Even in 1933, Nazi activists derided as opportunists those who joined the NSDAP after the March 1933 election, which was won by Hitler. As a result, party membership was restricted starting 1 May 1933.

[23] He suggested in a 3 April 1933 letter to the dean to award Adolf Hitler a doctorate *honoris causa*.

[24] Findeisen had also fallen out with two of his earlier assistants, Arthur Lisowsky and Walter Weigmann, and had sabotaged several theses defenses by doubting students' commitment to the regime and asking preposterous questions on the connection between the regime and business theory.

[25] Possibly to clear any doubt of his political attitude, Sandig, in 1933 and 1934, authored four articles on *Betriebswirtschaftslehre* and National Socialism and *Führer* responsibility in stock companies, which, inter alia, appeared in the Nazi daily *Völkischer Beobachter*.

Given the widespread demand for political commitment and accountability, these allegations could be expected to result in severe difficulties for both Sandig and the school. Findeisen's denunciations, however, were blocked by the school's concerted efforts. The student representative revealed in a written statement that Findeisen had only recently joined the Nazi movement, possibly to strengthen his cause against the school, and that he was a nuisance to everyone at the school. When a committee concluded that Sandig's habilitation was not communistic, Findeisen stated: "Of HHL's nine professors, eight belong into a concentration camp." Most likely due to his prior behavior and his history of ill health, Findeisen's attempted revenge failed. Instead, he was recommended to file a retirement request and, when he objected, was dismissed. Over the course of the next years, Findeisen appealed repeatedly to the decision, entering retirement only in January 1937.[26]

3.3 Implementing New Forms of Accountability: 1934 to 1935

On 29 March 1935, the *Reichsministerium für Wissenschaft, Erziehung und Volksbildung* (department of science and national education, henceforth: *Ministerium*)[27] announced to Dean Wörner, whose deanship was due to end on 1 April 1935, that his term would be extended for another year.[28] As a consequence, the ceremony, which would normally be held, was replaced by a written business re-

[26] In 1938, still listed as full professor of business at HHL, Findeisen (1938) wrote a book on marketing that was laden with Nazi rhetoric, quoting a wide range of Nazi books and outlets and treating topics such as "blood and property in marketing", "blood types in marketing" or "racial issues in marketing".

[27] The *Ministerium* was created on 1 May 1934 under supervision of Bernhard Rust. It appropriated the responsibility to appoint deans, but mostly based its decisions on the schools' suggestions.

[28] Wörner suffered from a declining health in his second term and, on 13 November 1936, solicited his dismissal from the department of education, which was granted effectively 31 December 1936. Vice Dean Snyckers had taken over as acting dean on 15 November 1936.

port, which the *Ministerium* requested from each school. The report was given on 15 February 1935 and contains only the dean's statement as well as faculty's reports on their activities.

Following some introductory remarks and thanks to HHL's contributors, Wörner showed his militaristic attitude by talking about his experiences as a soldier in World War I. In that account, he documented strong ideological alignment with the Nazi regime by stating "for the reporting dean, the National Socialist revolution […] was a mentally releasing event". He also reported that the transformation of HHL according to the new political and ideological conditions along the *Gleichschaltung* was well on track: "Right from the first day of my term, no adjustment was needed to entirely integrate HHL ideologically and organizationally into the empire of Adolf Hitler." Providing examples for the smooth transformation, he referred to the instruction at the entrance of HHL stating "The German salute has been implemented here. We say *Heil Hitler*!" and to the institution having ordered a portrait of Hitler in January 1934, which was unveiled in ceremony.

Before drafting his report, Dean Wörner had requested from each professor a contribution on their academic activities of about one page, which he presented in a subsequent section of his business report. As Wörner did not give any guidelines, each professor made up his report in the way he felt most adequate: Some of the accounts demonstrate strong ideological and political alignment (e.g. Wörner, Deutsch), whereas others simply list or briefly describe their lectures (e.g. von Hibler). In light of Snyckers' rhetoric in the June 1933 report, it is surprising that the former dean was amongst those that did not employ political slant. Possibly, he did not perceive a need for accountability since he was not dean, i.e. not in a position exposed to political accountability, and hence only compiled a list of his lectures. The episode shows how the perception of accountability is capable of changing the account.

Closing his report, Wörner confessed his wish "that HHL will continue to be able to work in self-administration, self-determination and self-reliance for the great tasks, which the *Führer* and *Reichskanzler* has set for the German commerce. *Heil Hitler*!" As an appendix, a number of student statistics are presented, inter alia on the proportion of non-Aryan and half-Aryan students. The disclosed figures show a decline from 1.1 percent in Summer 1933 (six non-Aryans) to 0.66 percent in Winter 1934/1935 (three half-Aryans). This report is the only one presenting such numbers on non-Aryan students. Both the statistic and Wörner's final remark imply that the dean aimed to ensure that HHL had been coordinated according to the *Gleichschaltung*.

Nonetheless, Wörner's report mentioned only in passing the constitutional change HHL had gone through during his term. Following Snyckers' attempt to implement a new constitution, the city of Leipzig, represented in the *Senat* by Council Member Stahl, raised the point again in August 1933 and presented a draft for a new constitution aiming to harmonize regulations with the University of Leipzig. Wörner, not agreeing with this draft, proposed a stronger integration of the *Führer* principle in the new constitution. Based on other German business school's constitutions, Wörner presented his own draft in October 1933, which was to make the dean the *Führer* of the school, granting him far-ranging authority. According to this draft, the dean was no longer accountable to his colleagues or the school's shareholders but only to the department of education. In November 1933, Stahl postponed further deliberations on the new constitution because a regulation from the department of education was to be expected.

Indeed, state secretary Michael in January 1934 asked Wörner for sample constitutions from other German business schools. Based on these documents and further discussions, the department of education drafted a tentative constitution, which specified that the purpose of HHL was to serve the German nation by economic education, teaching and research. HHL's *Kuratorium* amended this purpose by requiring an "education according to National Socialist ideology", further aligning the school's mission with politics. The change implies that, by being responsible for education and research, HHL's mission had technically remained the same. However, the objective of the mission was tilted in that HHL now had to contribute to the welfare of the German nation and subordinate its activities towards this goal. Gone was the guidance given by academic excellence and scientific advancements, which now seemed to be considered useless if they did not contribute to the German nation's welfare.

The remainder of the tentative constitution was approved in June 1934. Comprehensive authority was granted to the dean, who was appointed by the *Ministerium* and who, in turn, appointed his deputy and committees. Further implementing the *Führer* principle, the dean was given decisive power for all academic and curricular issues of the school. Had the *Senat* earlier been responsible for these decisions, did it now take only an advisory function. True to the Nazi regime's objective, power was concentrated on one person and had thus been centralized. The tentative constitution was superseded in April 1935 by the *Richtlinien zur Vereinheitlichung der Hochschulverwaltung* (ministry directives for a harmonization of university administration), which replaced all university constitutions and made all university deans *Führer* of the school, being solely accountable to the *Reichsminister* of Science and Education.

At about the same time, in June 1934, a decree was issued that united all lecturers at universities. The *Nationalsozialistischer Lehrerbund* (association of National Socialistic teachers, NSLB), which had been part of the NSDAP since 1929 and which, in 1933, had sponsored the professors' pledge to Adolf Hitler, comprised of a division for university teachers, within which a subdivision for lecturers had been founded.[29] Besides a federal and a state *Führer*, each university had its own *Führer* of the *Dozentenschaft* (i.e. all lecturers), who automatically took a place in the school's academic decision-making body.

A 4 July 1934 article in the local newspaper *Leipziger Neueste Nachrichten* explained the change introduced by the *Dozentenschaft* as follows: "In the past, the scholar trained himself solely in his research interests; he did not need the community, he abstained from it. His physical and political education was his private matter. The German revolution requires foremost a commitment to the community, an equal education of body and mind, the community of all German workers. The German university teacher is also a German worker. His responsibility is huge; his task is the education of emerging academics towards a German man, towards a strong character, towards a competent scholar. As a result, the aim of the German *Dozentenschaft* will be to promote the physical, political and scientific training of its members. The German *Dozentenschaft* wants to and will create a

[29] Membership was voluntary, although Professor Menz wrote to the dean on 24 July 1934: "I believe that it is appropriate that all faculty members that are concerned act uniformly in this regard."

new type of German academic, who is to an equal extent capable physically and scientifically and is thus qualified to contribute to the education of the academic youth and the erection of the Nazi state."

In July 1935, the position of *Führer* of the *Dozentenschaft* was renamed head of the lecturers in the course of a further centralization of power to the regional and national offices. Nonetheless, the local head of the now called *Dozentenbund* (association of National Socialistic lecturers, NSDB) still had significant rights because he was to be consulted prior to any staffing decisions made by the dean of the universities. Consequently, there were double checks not only regarding the scientific capabilities of a job candidate, but also, and foremost, regarding his political adequacy, as assured by the *Dozentenbund*. Deans, although being *Führer*, started to be accountable to the *Dozentenbund*. On the surface, the dean was solely responsible for every aspect of a university, but from then on his political commitment was monitored. For lecturers, the *Dozentenbund* implied that the regime was further encroaching on their lives. They were forced into an organization whose sole responsibility was to ensure its members' political alignment, disguised as a plea to stay physically fit and to socialize.[30]

Paul Deutsch, HHL's *Dozentenschaftsführer*, who *ex officio* replaced Karl Thalheim in HHL's *Senat*, reports in a 25 February 1935 letter to the dean that his tasks were to oversee that research and classes were aligned with the political

[30] In 1937, the NSDB became a compulsory organization in that membership was earned *ipso jure*, i.e. upon employment at the school. The tasks of the *Dozentenbund* were further reduced as they were solely seen to have an educational responsibility, which furthered political alignment.

ideas of National Socialism.[31] Special attention was to be given to students and young scholars, which were to become symbols of the Nazi state. Thus, beside the scientific education, the character of the young academics was given attention, e.g. by conducting obligatory camps, held jointly with National Socialist organizations. Members of the *Dozentenschaft* were also held accountable in terms of public political events. For example, the Leipzig chapter of the *Dozentenschaft* participated in the public march on 1 May 1935, which was the *Nationaler Feiertag des Deutschen Volkes* (national holiday of the German people). In a letter to all lecturers, dated 29 April 1935, Deutsch noted that absence had to be explained in written form and was acceptable only in case of ill health or participation in a different organization's march.

In summary, the regime introduced new hierarchies in the course of the *Gleichschaltung* to assure political commitment. As a result of the *Führer* principle, a strict line of command was installed along which everyone was accountable to their superiors. In addition, other organizations, such as the NSLB and the NSDB, introduced additional control of faculty's and staff's commitment to the regime. Accountability was not required by only one, but by many, superiors or supervisors and, consequently, dispersed throughout institutions and society. Due to centrally imposed responsibilities and lack of resistance to a timely organizational alignment, deviations from the ideologically and politically driven novel requirements were risky for professors and were thus avoided or done covertly.

[31] When Deutsch left HHL in 1941, Liebisch became the new local head of the NSDB.

4 Dispersion of Accountability: 1935 to 1945

4.1 Major Changes of HHL's Faculty: 1935 to 1937

Following the *Gleichschaltung*, the new reality at universities meant that compliance with the ideology was on display everywhere and at every opportunity. Arguably, it was in the years after the *Gleichschaltung* and prior to the war that the regime was the most entrenched. On the one hand, the economy had been recovering; on the other hand, the Nazi ideology emphasized the collectiveness of the nation and gave large parts of the German people a feeling of self-assurance and pride.

In this context, the formal inauguration of HHL's new dean was held. Although Snyckers had already taken over as dean from Wörner in the fall of 1936, he was entitled to a ceremonial act, which, at his choosing, took place on the *Führer*'s birthday, i.e. on 20 April 1937. Accordingly, the invitations were for festivities in honor of Hitler's birthday, which coincided with the transfer of the deanship. Snyckers unveiled a bust of Adolf Hitler at the school giving a short speech, which was sent to Hitler himself, honoring the *Führer* "in his dearest worship, thanks, and full of faithful wishes for you and your work. In the honor room of *Handelshochschule Leipzig*, your bust will from now on urge teachers and students alike to deploy everything for Nazi Germany and its *Führer*, for the idea and the man, in which we believe."[32] In his representation of the school, Dean Snyckers thus demonstrated the importance of the tone at the top. His actions,

[32] In his comments on the interim period from November 1936 to March 1937, Snyckers also mentioned the festivities for the beginning of the Nazi movement on 30 January 1937. At that occasion, Snyckers had urged students to be thankful to the *Führer* and to get engaged for his ideas.

undoubtedly, convey the impression that the school was fully aligned with the regime without leaving room for other opinions.

In the business report, which covered the period from Summer 1935 to Winter 1936/1937, a more factual account was offered. Wörner, not present due to ill health, reported on his deanship from April 1935 until November 1936, displaying political rhetoric only at the very beginning of his speech: "The legitimate claim to leadership by National Socialism, its special attention to the military sovereignty of the *Reich* and to the economic sovereignty, also need to determine the course of university policy." Thereafter, he elaborated sternly on university issues, such as contributions, faculty or lectures, without revealing ideological or political slant. This fact stands in stark contrast to Wörner's February 1935 written business report, which was full of ideological rhetoric. Either his ill health had gotten in his way of sporting enthusiasm for the regime or the nature of a written report, instead of a public speech, took away the pressure of political accountability.[33]

Overall, the report leaves a relatively neutral impression in that it did not include any political rhetoric. Even Snyckers' promise to perform his duty "for the salvation of our German fatherland" was reserved compared to the previous report. Possibly, holding the ceremony on the *Führer*'s birthday sufficiently displays commitment and compensates for a lack of ideological rhetoric.

Wörner also reported on the recruiting process for a *Professur für Menschenführung* (professorship for human leadership). The professorship could not

[33] The fact that Wörner's implementation of the *Führer* principle in the new constitution went unmentioned gives credence to this assumption. The chairman of the *Kuratorium*, Max Köhler, by contrast, acknowledged Wörner's efforts in this regard in his speech.

be implemented due to a veto by the city of Leipzig. The outgoing dean referred to the mayor of Leipzig, Carl Friedrich Goerdeler, who stated that HHL was first to give a number of lectures, e.g. by people from industry, before recruiting a professor. Mantel (2009, p. 233) conjectures that, behind closed doors, Goerdeler considered such a professorship to be an instrument for Nazi ideology. Confirming Goerdeler's fears, Snyckers, an advocate of that professorship, stated in a meeting of the *Kuratorium* that HHL should only recruit a man "who is fully trusted by the NSDAP".

The subsequent years were characterized by major changes of HHL's faculty. At a meeting of the *Kuratorium* on 19 January 1937, the need to recruit became apparent since two professors, Grossmann and Penndorf, were about to reach retirement age, one faculty member, von der Aa, had recently passed away, one professor, Schultze, had been dismissed, and two other faculty members, Wörner and Snyckers, were approaching sixty and were not in good health. As a result, a number of new faculty had to be recruited, being sought from HHL's own ranks and beyond. As will be shown, political concerns, officially termed "political reliability" of the candidates, often took a major role in the recruitment decisions, sidelining professional values such as academic or teaching excellence.[34]

In his 26 May 1945 report to the Allied military government, Thalheim claimed that, in spite of his SA membership, he had been unable to become a *planmässiger*

[34] We focus on those cases of relevance for accountability, whereas Mantel (2009, pp. 234-242) documents HHL's failed recruitments of Le Coutre, Lohmann, Stadler, Ruberg and Tiburtius in more detail. It is noteworthy, however, that, in 1944, the rejection of HHL's candidates went far enough for the chairman of the *Kuratorium*, Max Köhler, to write a letter of protest to the *Ministerium* asserting reputational damage for the school, referring to the severe lack of professors and lecturers during the war.

ordentlicher Professor and that several requests to the *Ministerium* had been denied. This bullying continued and, "in 1937/38, the then-dean of HHL, Professor Hasenack, who campaigned a lot for me, approached me following a meeting with the Saxonian department of education, telling me that he did not see a reasonable chance for me to obtain a paid professorship and that, as a result, he needed to recommend that I start looking for a position in industry."[35] Looking back, Thalheim asserted that at that point he surrendered, "demoralized by the years of fighting, being endangered time and again" (cited in Seeliger, 1966, p. 38). Automatically joining the NSDAP in 1937 due to his SA membership, Thalheim wrote a number of articles full of Nazi rhetoric, possibly showing political commitment to improve his career perspectives.[36] In 1940, he was given a full professorship for economics, claiming in his 1945 report that the department of education's change of mind was inexplicable for him.

Possibly, Thalheim became politically aligned as his 1943 service as an informant to the *Sicherheitsdienst* (the intelligence agency of the NSDAP) may suggest. Nonetheless, his association with the former mayor of Leipzig, Carl Friedrich Goerdeler, sheds different light on the HHL professor. Goerdeler was an active member of the 20 July 1944 assassination attempt on Hitler and stood ready to serve as *Reichskanzler*, had the attempt succeeded. Via his secretary, who also worked for Thalheim, the mayor approached the professor at the end of 1943, revealing his antipathy towards the regime, and asked the professor to compile a study of the economic consequences of Germany's military collapse. When the

[35] Thalheim's account needs to be assessed with a grain of salt because Hasenack joined HHL only in April 1938 and became dean in January 1939.

[36] A number of excerpts are reprinted in Seeliger (1966, pp. 27-35).

attempt on Hitler's life failed, Thalheim, who had started working on the study, destroyed his manuscript and escaped an interrogation by the *Geheime Staatspolizei* (secret state police, Gestapo). Goerdeler was less lucky and, on 2 February 1945, paid with his life for participating in the plot.

The anecdotes suggest that Professor Thalheim had partly kept his moral integrity, as evidenced by his assistance to Goerdeler. By contrast, his party membership and the change in his publishing behavior and writing style illustrate how career concerns caused him to disguise his posture. This behavior influencing effect of extreme accountability results in his betrayal of his own beliefs and his overtly abandoning of his morals. What remains are his published articles, likely written as disguise, whereas his true stance is ex post unknown.

Of particular interest is another recruitment case, in which the school witnessed an attempt to abuse the criterion of political compliance. In 1935, when HHL was looking to recruit a professor for wholesale and foreign trade, three candidates were considered. One applicant was excluded due to being a Social Democrat and another because of his health. The remaining candidate, Erich Schäfer from Nuremberg, was widely considered an adequate contender for the position. In a 12 December 1935 meeting, the *Kuratorium* agreed that it was the *Ministerium*'s job to decide on Schäfer's political reliability. HHL's *Dozentenschaftsführer* Paul Deutsch, who had been eyeing the position for himself, saw his chance to intervene for his own benefit. In a meeting with an employee of the *Ministerium*, Deutsch proclaimed that he had heard from the *Führer* of Nuremberg's student body that Schäfer "does not get along with the politically interested students. In addition, he is not politically active." Deutsch was only partly successful, mainly because his intrigues were seen through. Hence, he did not hinder Schäfer's recruitment to HHL, but succeeded in delaying Schäfer's appointment, who, first starting as a substitute, had to accept an adjunct position at HHL, only in 1939 becoming full professor. Paul Deutsch was nevertheless appointed full professor of merchandise and advertising in 1938, becoming the successor to Franz Findeisen.

Although not a success, Deutsch's attempted exploitation of the "political reliability" criterion shows that far-reaching accountability requirements encouraged denunciations, thus leading to abuse. On the part of Deutsch, personal interests had succumbed moral standards and truthful reporting. His allegations implied a bent in the recruiting of Schäfer, whose career became a pawn in Deutsch's striving to beat his rival for the position. If successful, his efforts would have had severe consequences for Schäfer, likely beyond the opening at HHL. Denunciations, encouraged by extreme accountability, thus have severe consequences for the affected person, but also for the informer, who is likewise ethically violated.

4.2 A Zealot Hands Over to a Liberal: 1937 to 1939

In October 1938, Dean Snyckers had left his office due to ill health and Paul Deutsch, Vice Dean since May of that year, took over as acting dean until January 1939. Snyckers wanted a much younger successor for his office and suggested as his successor one of his new colleagues, Wilhelm Hasenack, who had already been considered for the vice deanship in May 1938.[37]

[37] It is not known whether Snyckers was aware of Hasenack's critical attitude towards the regime (see below) or whether Hasenack was chosen simply because of his academic excellence.

At the inauguration of Hasenack on 24 April 1939, Snyckers, holding up the tradition, first reported on his term. Beginning his speech with a "*Führer* quote" on the definition of National Socialism, he added "to the honor of all my employees" that everyone at the school was always aiming to act as a good Nazi, thus guaranteeing political integrity for all of his subordinates. Within the factual part of his report, which named faculty changes, activities of the school's departments, and gave thanks to HHL's supporters, Snyckers also talked about the new examination and doctorate regulations, concluding that the changes were "essentially only formalities". However, the new doctorate regulations, approved in June 1938, restricted access to the doctoral examination. Foreigners needed approval from the *Reichserziehungsminister* (Secretary of Education) and Jewish applicants were excluded altogether from obtaining a doctorate. Instead, doctoral candidates needed to prove theirs, and their wife's, Aryan heritage. Besides changes to the format of the examination, the revocation of doctorates was reformed. Not only did academic or severe social misconduct induce the process of revocation. Anyone unworthy of a German academic title could lose their doctorate. The rule hinted at those who had lost their citizenship due to the *Reichsgesetz über den Widerruf von Einbürgerungen und die Aberkennung der deutschen Staatsangehörigkeit* (law on the revocation of naturalization and deprivation of the German citizenship) of July 1933. Thus, although the dean did not consider them of relevance, the changes to the regulations were substantial by bringing them further in line with the Nazi doctrine.[38]

[38] We are not aware of any HHL doctorates being revoked as a consequence of the amended regulations.

Snyckers continued his speech with accounts from his deanship, all of which were heavily influenced by political rhetoric. In these narratives, the dean averted any factual matter, demonstrating his fervor for the political regime. Reflecting on his first term, i.e. 1931 to 1933, Snyckers referred to the economic troubles and the changing political environment back then: “The screws of war contributions pointlessly squeezed out the last life from our economy and hunger seized large circles of our people. […] The time of the *Führer* was just beginning; his idea was embraced only by a minority of our fellow comrades. […] When I handed over my office on 14 June 1933 […], a new epoch, the concentration of our national power under the sign of the National Socialism carried by the *Führer*, had dawned upon Germany. It was at the last minute, at a time when Germany was starting to be flooded by Bolshevist chaos […] that the *Führer* stepped in at the top of our nation as the legitimate chancellor of the German *Reich*. […] And I was able to say from the bottom of my awestruck heart […]: ‘The German nation believes in the future again.’” Coming from a dean of a university, these words display crudeness and show the indoctrination of large parts of society, ranging far into university ranks.

Snyckers perceived his second term as being characterized by a thorough implementation of a Nazi-oriented education. Quoting from his June 1938 essay titled “The Significance of *Handels-Hochschule Leipzig* for the German economy”, he stated: “Business schools are to educate spearheads, who carry their belief in subordinating their own economic interests to the needs of a national fight for life, to their sense of responsibility for the entire economy.” Underscoring these words, Snyckers commented: “Those, who are obdurate to the *Führer*’s message and who are not earnestly trying to live up to the unequally minor things that are expected from their small existences compared to the welfare of the nation, affront the work of the *Führer* and thus their own people."

Concluding his speech, Snyckers appealed to the students, whose fortune it was to live in these times: "[N]o sacrifices were demanded from you […], the least you can do now is to fulfill your duties towards the *Führer* and the *Reich*, wherever your commitment is required. Open your hearts for the greatness and duty of our time and, through your actions, prove yourselves worthy to be Germans in the *Reich* of Adolf Hitler!" Exposing students to such an education and corresponding values did not bode well for students' education, but likely contributed to the Nazis' striving for uniform beliefs throughout society.[39]

Being the new dean, Hasenack followed the tradition of giving a scientific inaugural speech on "*Wissenschaft und Leben*" ("Science and Life"), whose title closely resembled Grossmann's 1930 speech. While his speech showed some rhetoric corresponding to the Zeitgeist, at times, it featured subtle criticism of the Nazi movement. Both elements were combined in a speech that aimed at defending science against ideological and political censure by proving how science positively affects life, making Hasenack's critique less apparent.

Mentioning the approving comments of German scholarship by people such as Hitler, Göring and Rust, Hasenack clarified that "thorough and clear work of the mind has nothing to do with sophisticated distortion of facts and doctrinaire ob-

[39] Seemingly responding to this plea, the *Führer* of the student body, Hoheisel, in a subsequent speech described the two virtues of the best German students on the basis of Hitler's ideas as: "First: Frenetic Nationalism […] Second: Profound earnest towards the true scientific problems of our time!"

tuseness. Otherwise, the political *Führer* and the General Staff, who also need to perform hard and rigorous work of mind, would be doctrinaires." Likewise, he mentioned three values that education needed to be directed at: "1. Absolute unconditional fulfillment of duties, 2. The skill to keep the mind clear if adverse circumstances create a confusing situation, 3. The strength not to succumb to mass suggestive influences of a negative kind as much as less educated people. […] The special task of the universities is to develop in people, who have the power to be a *Führer*, the skills of self-reliant evaluation, the power to assess life regarding whether or not its evolvement is in line with the political-national values of life. To do so, it is necessary for faculty and students alike to be components of the indestructible block of uniform faith and willing unity as which the *Führer* sees and creates his people." Appealing to universities' special task, Hasenack emphasized the moral integrity and self-reliance education was to convey. Mixing his plea with a call for political alignment allowed him to utter criticism.

Towards the end of his speech, Hasenack modified the widely used military slogan "*Führer*, Nation, Fatherland" by claiming that "the highest laws of life are united in the trinity: Nation, God, Truth". Concluding his talk, the new dean's approach towards regime criticism became most apparent: "[Science] can help overcome the great strangeness between some nations and let them find common parts of their tasks without giving up their cultural and racial particulars. At the end of our festivity, we honor the *Führer*, the man who in the next days will face difficult and directive decisions. To the *Führer* and *Reichskanzler* Adolf Hitler, the man, whom every German, be it a manual or mental worker, follows in unconditional devotion, a triple *Sieg Heil*!" The quote illustrates Hasenack's efforts to merge critical comments with ideologically and politically necessary rhetoric balancing political accountability with moral integrity. By doing so, he was able to go further in his criticism, which would become more apparent over the years of his deanship.

4.3 Hasenack's Opposition in Times of War: 1939 to 1944

Hasenack remained critical of the regime and avoided alignment with the Nazi ideology.[40] In 1939, he was able to leave the SA, which was extremely difficult and possible only if one was unfit to do service. Later claiming that he wanted to protest against the *Reichskristallnacht* of November 1938, in which the SA had taken a major role, Hasenack was examined, and deemed fit, by the medical department. Eventually, he was able to leave the organization by blaming his exit on the high workload, which he had as a dean.

When, following the war, students accused him of being a “Nazi professor”, Hasenack gave a detailed account of 37 pages, signed 20 December 1946, of his time at HHL and his covert work against the regime. Claiming that he had to disguise his true attitude by employing a “mimicry” strategy, he was able to criticize the regime, particularly in classes. He asserted that in HHL's student body only few supported the regime. All others fully trusted him and saw through his *Schutzanpassung* (protective alignment). They even supported him when, in 1941, Hasenack was reported to the Gestapo as a result of his rants against “science in marching boots” and “science with a sledgehammer”, defying Nazi propaganda against academe as the “rude tone of pigs”. Hasenack had been tipped off by Professor

[40] On 20 August 1946, the special committee of the Anti-Fascist Democratic Block of Saxony confirmed Hasenack's “conscious fight against Nazism”, giving credibility to Hasenack's case as an opponent of the regime. Still, Hasenack was dismissed from HHL's faculty due to his party membership and subsequently struggled to find re-employment. Only in 1949 was he re-employed at the University of Göttingen.

Kurt Schmaltz of Halle, who had an informant at the *Sicherheitsdienst* and was substituting at HHL for Friedrich Henzel, who at the time served in the military. Hasenack recognized the threat and immediately resigned as dean in Summer 1941.[41] At his initiative, he obtained funding from HHL's *Kuratorium* to draft a brochure on HHL, especially its work during the war, with which he aimed to redeem himself (Hasenack, 1941). In the brochure, Hasenack wrote about the activities of the school and described how the school could grow further. Employing Nazi rhetoric,[42] he sent his work to all HHL students and faculty[43] aiming at pacifying students and avoiding further spying and denunciations. Also, he distributed the brochure to all party organizations to discourage them from further investigations, which had been his intention with the brochure in the first place. Hasenack apparently succeeded in his efforts to portray himself as politically reliable, remaining at HHL until the end of the war.

His further actions give credence to this account because Hasenack continued to criticize the regime in his lectures. Some students, who complained that his comments made them doubt the regime, approached his assistant to make Hasenack stop from further statements. Others were less forgiving and, in February 1945, again attempted to report Hasenack to the Gestapo. At the forefront was the *Führer* of the student body of the University of Leipzig, who stated that Hasenack

41 He later claimed that his fear of consequences of his constant fighting against the regime challenged his health. Indeed, he had been receiving medical treatment since1940 and later took a medical leave.

42 The extensive appendices to his 1946 report, in which he listed as proof for his criticism excerpts from lectures, speeches and publications, show that the brochure included a considerable amount of subtle critique.

43 Hasenack asserted that "only two [of his colleagues] were more than nominal party members." One, who by 1946 had passed away, was a fervent advocate of the regime and the other, who by then had left the school, acted out of career concerns. Most likely, Hasenack referred to Snyckers, who as dean had shown his enthusiasm for the regime, and Deutsch, who was the head of the NSDB and published an article on *Weltanschauung and Wirtschaftsführung* (ideology and economic leadership) (Deutsch, 1934).

did not belong in a classroom, but in a concentration camp. The *Führer* of HHL's student body along with other students of the school sided with their professor, also because he was one of the few business professors left at HHL by then.

When Hasenack stepped down in 1941, the new dean, Arnold Liebisch, needed to be inaugurated. In the report on his deanship, which lasted from January 1939 until August 1941, Hasenack mainly referred to the effects of the war on HHL, giving largely a factual account.[44] Besides commemorating students who had died in the field, he mentioned that the school was closed from September to October 1939 when the war began. By ministerial order, the academic year 1940 had been restructured from semesters to trimesters, giving the faculty a higher teaching load, especially because half of HHL's male faculty and staff, among them all but one of the assistants, were in army service at that time. As a result, doing research became practically impossible for the remaining faculty.[45] In his speech, Hasenack explained how the school adapted to the war-time necessities and used the opportunity to complain about the war, thus indirectly criticizing the regime.

Hasenack's careful opposition is further demonstrated by an episode surrounding HHL's most prominent alumnus, Eugen Schmalenbach, who in 1923 became an honorary citizen and in 1930 an honorary member of HHL's *Senat*. Schmalenbach in 1933 was forced into retirement because of his critical attitude towards the regime and his wife being Jewish (see, e.g., Kruk, 1984, pp. 150-153; Mantel, 2009,

[44] To the best of our knowledge, the report exists as a manuscript only, but was not published, most likely due to shortage of paper during the war.

[45] The three major German business research journals stopped publishing soon thereafter: The *Zeitschrift für Betriebswirtschaft* appeared until 1942, *Die Betriebswirtschaft* until 1943 and the *Zeitschrift für handelswissenschaftliche Forschung* until 1944. Hasenack later claimed that, in 1942, he stopped publishing anything other than reissues of books due to increasing censorship.

pp. 392-405). Due to his reputation, at least a considerable part of the academic community stood by Schmalenbach's side even during the Nazi regime. Accordingly, a 4 June 1936 ministry decree regarding the tacit omission of the names of Jewish lecturers and honorary members of schools' senates from directories remained of no consequence and Schmalenbach remained listed in HHL's directory. Nonetheless, repressions increased over the years and the academe's support wavered. When on 14 September 1939 Schmalenbach's house was raided by the Gestapo and a defaming article appeared in two newspapers, Hasenack in a 5 October 1939 letter asked Schmalenbach's closest disciple, Ernst Walb, to appeal to Schmalenbach to resign as honorary member. He wanted to avoid the school to become active against such a reputable man. In his answer, dated 7 October 1939, Walb calmed Hasenack down stating that it would be harmful to HHL if the school withdrew Schmalenbach's title. He further pointed out that there was no need for HHL to take any action since at the moment they did not have to print a directory and, by the time they had to, things would look differently. Indeed, Hasenack let the matter rest and, subsequently, became an advocate for Schmalenbach, enjoying professional and personal correspondence over many years.[46]

In 1943, professor emeritus Findeisen raised the issue again, asking for Schmalenbach's removal as an honorary member of the senate. In a concerted effort, Dean Liebisch and Hasenack appealed to the department of education to avoid Schmalenbach's removal, pointing to his reputation and alleging that Schmalenbach's work was used by the military. While the matter dragged on for several

[46] According to Kruk (1984, p. 142), Hasenack was a frequent guest of Schmalenbach's. In addition, Schmalenbach supported Hasenack financially, when Hasenack was unable to find reemployment following the war (Kruk, 1984, p. 144).

months, HHL eventually removed Schmalenbach's name from their directory in Summer 1944.

4.4 Outlook – The Regime's Dissolution: 1945

As dean, Hasenack had also had several disputes with the department of education and later asserted that, upon his stepping down, the relationship between HHL and the *Ministerium* improved considerably. This effect was rather due to a personal feud of Hasenack's than the political alignment of Dean Liebisch, who was eager to have a less turbulent relationship with the *Ministerium*. Liebisch, who became close friends with Hasenack, led HHL in increasingly difficult times from August 1942 until April 1945. Fulfilling the teaching duties had become complicated: Some of HHL's professors, such as Friedrich Henzel, were fighting in the war; others, such as Deutsch and Schäfer, had left HHL or, in the case of Snyckers, retired due to ill health. Liebisch was not able to recruit substitutes due to political concerns regarding the candidates (see above).[47] When HHL was hit in an air-strike on 4 December 1943 and briefly closed in a war-time effort in the fall of 1944, Liebisch grew increasingly frustrated and was looking forward to the end of his deanship. Nonetheless, without asking for Liebisch's, or other deans', consent, the department of education extended the dean's term in office as a result of the war. When, in April 1944, the department of education indicated that a change in office was possible, the chairman of the *Kuratorium*, Max Köhler, against the dean's will, petitioned to extend the term. By then, the war had rendered any meaningful university activities difficult and it slowly dawned upon Germany that the regime's days were numbered. In letters, HHL professors were increasingly talk-

[47] The fact that the candidates he preferred were put down by the *Ministerium* gives an indication of Liebisch's political attitude. He seemed to prefer scientifically qualified over politically aligned candidates.

ing about “the time after the war.” In April 1945, Leipzig was seized by the U.S. army. In the same month, Liebisch resigned from his office.

On 1 May 1945, the remainder of the *Kuratorium* elected Friedrich Lütge as HHL’s new dean. The appointment of Lütge, who had not been a member of the NSDAP, showed that the school started planning for the time after the Nazis, whose regime collapsed only days after Lütge’s election. Due to his lack of party affiliation, the new dean oversaw the end of the war and the dismissal of most of his colleagues due to their party membership in November 1945. In a subsequent letter writing campaign, most likely to the military government, he requested that HHL’s faculty remain in office. His letters included mainly two arguments: One was that his colleague was indispensable for HHL and the other explained how their party affiliation came about. As a result, several professors were re-appointed on temporary “emergency” contracts. Nonetheless, the school itself did not survive for much longer. As early as July 1945 did HHL’s *Senat* follow up on a long-held plan and consider integrating the school into the University of Leipzig, which was successfully completed in February 1946.

5 Conclusions

In this article, we examined the concept of accountability under extreme societal conditions at Germany's first business school, the *Handelshochschule Leipzig*, during the Nazi regime. In narrating and interpreting school activities, we shed light on how the Nazi regime affected universities, particularly business schools. We argue that the political reign of Adolf Hitler imposed extreme external conditions on the German society, including universities as institutions of higher morality. The regime centrally designed changes to the universities' regulations, aiming to coordinate them with party ideology. It became clear early in the regime that schools and their faculty had to consider Nazi ideas in education, research and recruiting alike. The state, and its quest for "political reliability", affected almost every decision and constantly required accounts, which were given, in the case of supporters, by expressing their devotion and commitment to the ideology and, in the rarer cases of opponents, by considering potential repressions and negative consequences of their actions.

The regime implemented a control state that took advantage of the socio-economic travails in Germany by creating wide-spread enthusiasm for the Nazi ideas. As a result, commitment to the regime was required and, if not displayed, entailed severe negative consequences. In turn, to avoid penalties, the accountable self was either to lie quiet or to politically align and give up his moral beliefs. We report several cases of the latter kind when, out of career concerns, people committed themselves to the regime.

As a result, professional accountability changed considerably for professors. Had they traditionally been dedicated solely to scientific advancement and educating students, were they now obliged to, or chose to, show political alignment. Consequently, while their tasks did not change, objectivity, scientific rigor, and educational objectives were distorted by political concerns. A new line of command, the *Führer* principle, and new forms of bureaucracy formed a control state and aimed to ensure political alignment. In addition to superiors checking political reliability, inferiors and colleagues could also question an individual's commitment. Denunciations, as we report, were attempted to a considerable extent, also in cases when the allegations were not true. Such actions, which were a consequence of the regime's paranoia, violate the integrity and dignity of both informer and victim. Thus, besides forcing alignment upon individuals, denunciations represent a major threat of excessive accountability by pressuring the accountable self to abandon internalized morals, that, due to being enforced by psychological controls, are otherwise "particularly powerful and binding" (Sinclair, 1995, p. 230).

Appendix: HHL Faculty during the Period from 1933 to 1945 – Ordered by when they joined the Faculty[48]

Name	Faculty Member	Office Held
Wörner, Gerhard	1911 – 1940	VD: Apr 1912 – Mar 1924
	Management of insurances	D: Apr 1933 – Nov 1936
Grossmann,	Apr 1916 – 1938*	D: Apr 1928 – Mar 1931
Hermann	Tax accounting	VD: Apr 1931 – Mar 1933
		Apr 1937 – May 1938
Schultze, Erich	May 1922 – Mar 1940	D: Aug 1922 – Mar 1924
	Economics	VD: Apr 1924 – Mar 1926
Penndorf, Balduin	Oct 1922 – Dec 1938	D: Apr 1926 – Mar 1928
	Business	VD: Apr 1928 – Mar 1931
von der Aa, Karl	Apr 1923 – 1936	D: Apr 1924 – Mar 1926
	Business school pedagogy	VD: Apr 1926 – Mar 1928
	(*Handelsschulpädagogik*)	Aug 1934 – Dec 1936
Findeisen, Franz	Apr 1925 – 1933	–
	Merchandise and	
	advertising	
Menz, Gerhard	Oct 1925 – 1951	–
	Management of book trade	
Snyckers,	Apr 1929 – Mar 1945	D: Apr 1931 – Mar 1933
Alexander	French business language	VD: Apr 1933 – Jul 1934
		AD: Nov 1936 – Mar 1937
		D: Apr 1937 – Oct 1938
von Hibler, Leo	Nov 1929 – 1945	–
	English business language	
Deutsch, Paul	1931 – Sep 1941	VD: May 1938 – Oct 1938
	Merchandise and	AD: Nov 1938 – Jan 1939
	advertising	

48 This list includes HHL professors at all levels and was compiled from course catalogues, staff records and other files in the archives. In several instances, we could not confirm the exact dates of professors' employment since we found contradictory dates.

Geyler, Friedrich	Apr 1931 – Nov 1945* Tax law	–
Kirchberger, Hans	Apr 1931 – 1933 Industrial property law	–
Thalheim, Karl	Apr 1932 – Nov 1945* Economics	–
Wünschmann, Feodor	Apr 1932 – Sep 1935 Tax law	–
Schäfer, Erich	Apr 1936 – Mar 1942 Wholesale and foreign trade	–
Löbner, Walther	Jan 1938 – Nov 1945* Business school pedagogy (*Wirtschaftspädagogik*)	VD: Aug 1941 – May 1945
Hasenack, Wilhelm	Apr 1938 – Nov 1945* Banking and taxation	D: Jan 1939 – Aug 1941
Henzel, Friedrich	Nov 1938 – Nov 1945* Industrial management	–
Liebisch, Arnold	Nov 1938 – Nov 1945* Commercial law	VD: Jan 1939 – Aug 1941 D: Aug 1941 – Apr 1945
Lütge, Friedrich	Apr 1940 – Mar 1947 Housing development	D: Apr 1945 – Feb 1946
Tiburtius, Joachim *(substitute)*	Oct 1943 – Mar 1945 Trade management	–

Note: D = Dean; VD = Vice Dean; AD = Acting Dean; * denotes faculty members who were dismissed for political reasons after the war. Following his retirement, Grossmann had continued to teach part-time at HHL.

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Eidesstattliche Versicherung

Versicherung nach § 9 Abs. 3 der Promotionsordnung der HHL Leipzig Graduate School of Management vom 3. Dezember 2009:

Hiermit versichere ich, dass ich die vorliegende Arbeit ohne unzulässige Hilfe Dritter und ohne Benutzung anderer als der angegebenen Hilfsmittel angefertigt habe; die aus fremden Quellen direkt oder indirekt übernommenen Gedanken sind als solche kenntlich gemacht. Bei der Auswahl und Auswertung des Materials sowie bei der Herstellung des Manuskripts habe ich keine Unterstützungsleistungen erhalten. Dritte haben von mir weder unmittelbar noch mittelbar geldwerte Leistungen für Arbeiten erhalten, die im Zusammenhang mit dem Inhalt der vorgelegten Dissertation stehen. Die Arbeit wurde bisher weder im Inland noch im Ausland in gleicher oder ähnlicher Form einer Prüfungsbehörde vorgelegt. Mit der vorliegenden Arbeit wurde an anderen wissenschaftlichen Hochschulen noch kein Promotionsverfahren in Wirtschaftswissenschaften beantragt.

Leipzig, 26. April 2013

Dominic Detzen, M.A. HSG

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